OECD Reviews of Regulatory Reform

Taking Stock of Regulatory Reform

A MULTIDISCIPLINARY SYNTHESIS

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Taking Stock of Regulatory Reform: A Multidisciplinary Synthesis

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Executive Summary

The importance of a high quality regulatory environment was underlined by the OECD several years ago with the adoption in 1997 by the OECD Council of the Report on Regulatory Reform and its seven Principles of Regulatory Reform. Since then, the OECD has carried out twenty multidisciplinary country reviews to assess progress, as well as research on the link between reform and economic performance. This report, which is based on detailed assessments of countries' progress in regulatory management, competition policy, market openness and sectoral reform, reviews developments and points the way forward to an update of the 1997 Principles. In 2005, the OECD Council endorsed the Principles of Regulatory Quality and Performance.

Research since 1997 on the drivers of economic growth confirms that product market reforms, including regulatory reforms, help performance. In particular, there appears to be a strong link with better productivity, as well as higher employment rates. Reducing barriers to trade, promoting domestic competition, and simplifying administrative procedures are among the policies that help performance; where barriers and complexity remain, progress is slow.

The reviews highlight the importance as well as the range of public policy goals which countries seek to pursue. Regulatory reform is not just a tool for market opening and for improving the prospects for economic growth. Economic policy goals have a central place, but other welfare goals such as balanced regional development can also be very important. Regulatory policy and reform are just as relevant to the achievement of these other public policy goals.

The evidence of the country reviews shows that the different disciplines contributing to quality regulation are mutually supportive, lending weight to the argument that a "whole of government" approach is needed. The 1997 Principles give competition policy a prominent place, but the review of progress underlines the need for realism about the extent to which competition principles are applied in practice, even today. There is some way to go in developing the link between competition policy and the rule-making process. The market openness reviews also reflect concern over the extent to which the trade perspective is fully integrated into the domestic regulatory framework. Sectoral reforms are being pursued albeit with some difficulty in many cases, though this can be partly explained by the fact that the reviews have focused on sectors with challenging characteristics such as electricity. Assessment of progress on the rule-making framework has focused on regulatory policy, regulatory institutions, and regulatory tools such as Regulatory Impact Analysis, the three pillars for an effective regulatory management system. Progress is visible under each of these headings, but uneven. Developments in most countries are fragmented, falling short of a strong "whole of government" approach to ensuring regulatory quality.

Although there is significant common ground between countries on broad policy objectives, there is also great diversity in implementation. Best practices are emerging in many areas but have not always been adopted. Countries have much to learn from each

other on best practices, as well as the poor practices which need to be avoided. A deeper cultural change within government and better communication are often needed to secure a full understanding of the importance of high quality regulation. Transparency, including active efforts to engage all stakeholders, emerges as the cornerstone of a well-functioning regulatory process.

Introduction

The OECD has collectively underlined the importance of a high quality regulatory environment since the mid 1990s when the Council adopted the 1995 Recommendation on Improving the Quality of Government Regulation and its checklist as the first international standard on regulatory quality, and the 1997 Report on Regulatory Reform and its Principles of good regulation (see box below).

The 1997 Principles of good regulation

1. Adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.
2. Review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively.
3. Ensure that regulations and regulatory processes are transparent, non-discriminatory and efficiently applied.
4. Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.
5. Reform economic regulations in all sectors to stimulate competition, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.
6. Eliminate unnecessary regulatory barriers to trade and investment by enhancing implementation of international agreements and strengthening international principles.
7. Identify important links with other policy objectives and develop policies to achieve those objectives in ways that support reform.

Source: OECD *Report on Regulatory Reform*, 1997.

Since 1997, the OECD has carried out a series of country reviews based on the Principles, which have documented progress in the reviewed countries. Twenty OECD countries have been reviewed.[1] The reviews have been multidisciplinary, covering the broader economic context, competition policy, market openness, sectoral reforms and not least, the development of regulatory policies, institutions and tools to build up capacities for a high quality rule-making environment supportive of economic growth and specific policy goals. This work has been complemented by the specific research of the OECD secretariat and others on issues such as the link between product market reforms and economic performance. Ample material is now available to take stock of the progress made in OECD countries and to reflect on the continued relevance of the 1997 Principles.

This report integrates more detailed papers prepared for the committees and working parties responsible for regulatory management, competition policy and trade, as well as relevant papers prepared for the Economic Policy Committee.[2]

Notes

1. Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Mexico, Netherlands, Norway, Poland, Spain, Turkey, United Kingdom, United States.
2. GOV/PGC(2004)11/REV1, DAFFE/COMP(2003)19/REV1, TD/TC/WP(2002)25/FINAL, DAFFE/COMP/WP2(2003)9/REV1, ECO/CPE(2003)19, and ECO/CPE(2003)19/ANN.

Chapter 1

The Overall Picture: The Interdisciplinary Perspective

A mutually supportive agenda

The stocktaking exercise confirms that the different policies and perspectives which have been examined under the country review project are mutually supportive. This underlines the importance of viewing different policies from a holistic or "whole of government" perspective:

- From the high level economic perspective, product market regulatory reforms are an important component of structural policies that support sustained economic growth.
- The competition policy reviews highlight a close and positive relationship between the objective of promoting competition policy principles, and that of promoting high quality regulation and regulatory reform. Competition policies are stronger and more coherent, and regulatory policies are strengthened in a key part of their agenda – promoting competition and market openness – where they have supported each other to promote reform.
- Effective regulatory policy and market openness also support each other. Foreign as well as domestic businesses are encouraged by an effective regulatory environment. The significant overlap between the themes picked up in the regulatory quality and market openness reviews underlines this. It is, for a large part, a shared agenda.
- The application of competition principles is one of the six efficient regulation principles for market openness, highlighting the fact that the latter is well served by progress in the application of competition principles. The market openness reviews underline a number of competition policy best practices, such as strong competition oversight and enforcement mechanisms, which support international trade and investment.

The importance of good governance: regulatory policy is part of a wider framework for policy integration

Government, including government in its regulatory role, is a necessary element of well-functioning democratic market economies. The goal is to manage that role in such a way that it helps to meet policy objectives without imposing unnecessary burdens. This is especially important when the public sector does not directly provide services, but still sets objectives and standards. In this context, the link between regulatory policy and the broader governance framework is critical. Regulatory policy is already a key part of the OECD's work on governance, the goals of which are transparency, legitimacy, accountability, trust in government, efficiency and policy coherence. The reviews confirm that competition law and policy are key elements of the broader governance framework. Their links with major regulatory reform has been very strong in the recent development of some OECD countries, competition policy acting as a powerful spur to market opening and deregulation. Competition principles need further embedding in regulatory processes. The more recent reviews draw attention to other governance issues that matter, such as the structure of industrial relations and wage bargaining. Achieving labour market policy

goals, for example, requires a mix of effective regulation and attention to the underlying structures that drive labour markets in specific countries.

Achieving policy goals with the support of high quality regulation

Regulatory policy can be assessed as a general process for helping to meet policy goals.

Meeting policy goals

Regulatory policy can make a broad contribution to public policy goals and the policy-making process. It can encourage new or previously unheard stakeholders into the policy debate, so that policy is better grounded. It can promote timely and necessary change to support social as well as economic renewal, so that this can take place more quickly and at least cost. Virtually all the country reviews have examples of how quality of regulation has affected economies and societies.

The reviews highlight the breadth and detail of the public policy goals, both for specific sectors and more broadly. An economic assessment focused on product and labour market policies by definition does not capture other issues and the broader public policy context for government actions. This is important from a political perspective: all the country reviews show that other public policy goals clearly matter. If they are not taken into account, there is a risk that regulatory policy and reform may run into difficulties because it is not seen as relevant to, or able to deliver on, other policy goals, and is too narrowly associated with a particular issue: market opening.

Effectively implemented, regulatory policy is an integral part of the process which links a policy goal, policy action, and regulation to support the policy action. There is a powerful relationship between policy development and regulatory development. A well-implemented RIA illustrates this.[1] By dissecting the purpose of a proposed rule it helps to define the policy goal. These statements may appear self-evident to the proponents of regulatory quality in government, but an understanding of this link is not yet widespread. Integrating regulatory quality into government processes requires a "re-engineering of policy development". It is not simply a matter of grafting on. Effective implementation of RIA remains, however, a widespread challenge.

The broader challenge is to make the link between whole regulatory regimes, not just individual rules, and policy goals. Regulatory policy is not about specific regulations for a sector, but about the process by which regulations are drafted, updated, implemented and enforced. It helps define the interface between the State, society and the economy. At the same time, regulation should not become the only issue in assessing policy successes and failures, as other policies such as structural change may also be relevant.

The cumulative effect of rules over time is an important consideration. Existing regulation and regulatory processes can block progress in meeting policy goals, if they are not adapted. Regulatory frameworks need regular review so that they can continue to meet original policy goals, as well as complete reworking to meet new policy goals. Anticipation is also important: for example planning ahead for the regulatory and other reforms that will be needed to facilitate the adaptation of economies to ageing. These processes are not yet handled as effectively as they might be in most countries.

Policy goals: clarity, complexity, overlap and trade-offs

What does government want to achieve? What is the desired outcome, for which new or reformed rules, regulatory frameworks or deregulation are needed? If the policy objective is clear, it is easier to define the necessary rule(s) to meet it. If the policy goal is not clear, it will be difficult to design effective rules. If other necessary actions such as structural reforms are not also taken, the rules may not have the desired effect.

Policy making also increasingly requires solutions that cross ministerial boundaries because of policy interactions, and the need for trade-offs to deal with policy conflicts.[2] Dealing with these interactions and conflicts is difficult. Some interactions are not easy to spot or anticipate.[3] Policy conflicts do, however, need to be managed. Ways of doing this might include the identification of recurrent policy "trade-off" problem areas and developing a stronger awareness of how/which policy goals interact; strengthening the intra-governmental cooperative arrangements for dealing with these areas; and last but not least, ensuring that regulatory tools such as RIA are deployed to help find a way forward. Regulatory policy can help to tease out the balance which may need to be struck between policy goals.

Achieving the right balance between different and sometimes conflicting policy goals is a recurring theme of the competition reviews, which analyse the extent to which competition principles are driving the rule-making process. The reviews conclude that exclusions and special regimes that limit the reach of competition principles are often due to the balance countries seek in meeting other policy goals and public interest considerations such as equity and redistribution. The reviews do not question the legitimacy of these other considerations, but they do raise the issue of whether approaches that sideline the application of competition principles are the best way to achieve the goals in question, and whether the right balance has been achieved.

Putting regulatory quality to work

Regulatory policy can also be assessed in terms of how it has helped, or could in future help, to achieve specific policy goals. The country reviews have provided some answers to this question. They have made an important start with policies for international market openness, the infrastructure industries and other sectors such as professional services. The more recent country reviews suggest scope for making the link with an even broader range of policy areas.

Implementation of current policy targets: uneven "work-in-progress"

Research now provides some valuable evidence of the contribution that can be made to general economic performance by effective regulatory frameworks and regulatory reform in specific areas. In particular, product market policies and regulatory reform help to boost productivity. Specific reforms that have been identified as helpful for this are market openness, competition policy, infrastructure and service industry reforms, and the reduction of administrative burdens. There appears to be a positive relationship between reforms of these sectors and areas, and trend economic growth.

There is a broad convergence of views on progress so far. The economic reviews, which consider the important but relatively specific issue of competition in product markets, note that there have been significant developments in product market policy and regulatory frameworks and a visible but very uneven development of competition. Tariff barriers to

trade as well as restrictions on FDI have for the most part declined substantially. Competition law and policies have become generally stronger. There has been progress too with administrative simplification, identified as another important component of market openness. But closer economic analysis shows that product market regulatory reforms are still needed because many countries still have relatively closed markets in important services and infrastructure sectors.

Specific policy challenges

Further, often considerable, progress needs to be made on some of the current agenda of what used to be known (and often still is known) as "regulatory reform",[4] such as reducing administrative burdens.

Deregulation is still needed for closed and sheltered product and service markets. The retail trade, pharmacies, professional, legal and other services, taxi services and other markets are still relatively closed in many countries. Barriers to new market entry remain, which may not always be justified.

Although reforms of the network sectors have been singled out as an important element of product market reform leading to better overall economic performance, the reviews underline the difficulty of ensuring a high level of competition in electricity and gas. The reviews also show that although countries differ in their starting point for reform, and in their institutional and cultural constraints, they all have to grapple with common themes. Finding solutions to some issues is still very much work-in-progress. It is clear too, that developing and sustaining competitive markets once they have been opened to competition requires continuous regulatory effort.

An emerging challenge: the public sector

A major issue highlighted by the most recent country reviews is the public sector,[5] and its comparative neglect in the practical application of the regulatory quality agenda. The public sector is a very large part of the economy of all OECD countries. The public spending to GDP ratio in the OECD area stood at slightly over 40% in 2002.[6] Containing and reducing public expenditure is a challenge for many OECD countries, not least because of pressures to spend more on core issues such as health and education, which are nearly universal across the OECD. In many countries, ageing populations are putting more demands on health services as well as public pension provision.

This means that an important part of the regulatory quality agenda needs to be about "regulation inside government" (Box 1.1). This is not an issue about the size of the public sector, but about its management. The application of regulatory quality principles inside the public sector and at the interface of the public and private sectors is just as important as their application to the private sector. This aspect of regulation should in principle be subject to the same regulatory quality standards of efficiency, effectiveness, transparency and accountability as other regulation. If efficiency and productivity can be raised in this part of countries' economies through wider use of regulatory quality principles alongside other policies, it would have a major impact on economic performance and social welfare.

Improving efficiency, promoting quality and investment

This topic is not narrowly or exclusively a matter of containing costs. Investments are needed in public services, which have considerable and positive impacts on regional and

Box 1.1. **Regulation inside government**

Regulation inside government refers to regulation where a public body has an official mandate to regulate the activities of another public body. This type of regulation is much less explored and understood than the regulation of the private sector, especially business. However adopting the regulatory perspective offers opportunities for "reading across" approaches developed in the regulation of business. While the burden regulators place on regulated bodies, and their sometimes conflicting demands are big issues in regulation of the private sector, they are less discussed in the context of regulation inside government. Adopting the regulatory perspective allows regulation to be identified as a distinct activity in the public sector common to many types of body that are normally looked at in isolation. Once the regulatory aspects of activity in the public sector are recognised, there are opportunities to adapt the techniques of private sector regulatory management (such as Regulatory Impact Analysis) to improve the quality of regulation inside government and reduce its burdens, which will contribute to improving the performance of the public sector.

The cost of regulation inside government is one important reason for paying more attention to it. For example it is estimated that direct running costs of UK regulators of the national public sector range from about £700 m to £1 billion, and this does not include compliance costs incurred by regulated bodies. Another striking feature is the growth of regulation inside government in recent years. Research suggests that substantial systems of regulation inside government exist across OECD countries, although there is, unsurprisingly, substantial variation in their scale, institutional structure, modes of working and effects.

Source: Regulation Inside Government: Scale, Scope and Policy Implications, paper prepared by Dr. Oliver James, University of Exeter, for the OECD Public Governance Committee in September 2004.

national competitiveness, and on the relations between citizens and the State. Competition in public services to improve efficiency is nevertheless an important issue. When public services are provided directly by the State without any competition, their value cannot be measured, as there is no market for these services. Introducing competition with market providers allows some basis to be established for the valuation of services. It is then possible to relate the cost of inputs to a market price for the output. Productivity and efficiency gains should follow.

Competition in public services

OECD countries vary in the extent to which they are prepared to allow competition in the delivery of public services, and the private provision of public services. An agreed definition of which parts of the public sector can or should be exposed to competition does not exist across the OECD. A number of factors affect the definition, some of which are specific to particular countries or cultures. OECD countries offer a complex and extremely variable picture of State and private interactions, with differences in the definition of the public sector, linked to deeply embedded views about the role and responsibilities of the State in the economy and society.[7] In many countries the regulatory quality agenda needs to include the development of a more coherent framework for tackling the issue of competition in the public sector, and linked governance developments.

Careful handling is needed where public services have been opened to competition and the State continues to be a significant owner, to avoid discrimination against private companies, and to maximise the pressures for efficiency on State entities. The concept of the "regulatory State" is especially important in these cases to separate the regulatory, commercial and ownership roles of the State. The State cannot set public policy goals to be met by the market overall, if it is owner/shareholder of an entity (and what is more, usually the historic and still dominant incumbent) in that market, its direct operator, and regulator of the sector, without raising problems for effective competition. This leads to conflicts of interest between the various mandates of the State. As owner/shareholder the State will be tempted to maximise profits for its entity, which jeopardises an even handed oversight of the market. If it retains a direct role in the company's operation, this adds to the problem of potential discrimination against competitors but also raises the issue of how to maintain pressure for the company to be efficient (the company may be cushioned by various advantages such as State guarantees). If the State also retains direct responsibility for regulation of the market, this is especially damaging for competitive neutrality.

Tackling these issues requires a coordinated set of policies, not just regulatory policy but other policies such as competition policy and corporate governance. As regards competition policy, the reviews note that competition law usually applies only to the commercial operations of State-related entities, which limits the scope for applying competition principles to these entities as a whole. Regulatory policy has two major contributions to make in the mix of policies that are relevant. First, and most important, it provides the impetus for setting up independent regulators and improving their institutional design. Second, it can provide input to establish effective rules for competitive neutrality frameworks,[8] as well as public sector corporate governance frameworks.

Public services and local government

Application of regulatory quality to public services at the local level needs special attention. In most OECD countries the local level of government has important responsibilities for public services. These vary, from simple delivery of services controlled and regulated from the centre, to responsibility for developing and implementing the rules for service delivery. But whatever the framework, the regulatory quality agenda urgently needs to be brought to bear to this level of government. Public procurement is a key issue at this level.

Overall, there is progress to be made on the effective management of "regulation within government": tools are relatively undeveloped, best practice not always yet identified, reforms often need to be country specific, and there is likely to be considerable resistance to change. Most important perhaps, the appropriate role of the State in public services remains to be defined in the wider governance framework.

The way forward: encouraging a more effective regulatory framework for policy making and policy goals

The regulatory quality agenda is still work-in-progress. Although best practice[9] is emerging in many areas, there are often widely differing rates of progress across countries. Developing an effective regulatory culture takes time, and the reviews tend to confirm that the countries which have been engaged in the process the longest are the furthest down the road. But broadly, there is still a lack of cultural awareness across regulatory institutions of what high quality regulation can do, and how to achieve this. Regulatory

policy needs to link up with other policies and processes if it is to have the influence it deserves. The three pillars of regulatory quality – regulatory policy, regulatory institutions and regulatory tools – need strengthening.

The competition reviews note the need to be realistic about what has already been achieved in relation to embedding competition principles in the regulatory culture, and how much remains to be done. For some countries this implies a reappraisal of the place that competition principles should have in guiding economies and societies. In others, where this is already an important element, it means making a stronger practical link between competition law and policy, and the rule-making process.

The market openness reviews highlight important progress with transparency including use of the Internet. Progress is also noted on trade-specific issues such as the use of internationally harmonised measures. But at the same time they show that there is still a long way to go in embedding the concept of non-discrimination in regulatory culture, echoing an equivalent concern of the competition reviews about embedding competition principles. Awareness of the domestic regulatory culture to these issues clearly needs to be raised. It seems almost as if the different perspectives still operate in separate "boxes", a point supported by the market openness observation that trade and regulatory policy officials need to communicate more.

The institutional framework: better coordination among a very broad set of relevant institutions is essential

One of the most important issues to emerge out of the regulatory quality reviews, echoed by the other reviews, is the importance of a "whole of government" perspective for developing high quality regulation.

All central – and local – government institutions need to be part of the picture. The different parts of central government – the executive, the legislature and the judiciary – each have a key role in the rule-making process. To make durable progress in the face of the traditional compartmentalisation of functions, some form of central mechanism seems essential, though each country's context needs to be taken into account in developing an appropriate structure. The country reviews suggest that an effective, comprehensive regulatory policy goes hand-in-hand with the existence of a central oversight body. Subcentral governments are becoming more important in many OECD countries, with the delegation of responsibilities. But this means paying closer attention to regulatory quality at this level too.

Independent regulators are an important development over the last few years. This development is broadly very positive as independent regulators are helping to promote transparency and market competition, but the extent and management of their independence needs further work.

Competition bodies have an important role to play in the enforcement of competition rules that are fundamental to the effective functioning of market economies. They can also be advocates for better regulatory quality if they have a policy role too. Their relationship with sectoral independent regulators needs to be well conceived in order to avoid different interpretations of the competition law and to manage conflicts with sectoral laws. The need to associate trade policy bodies more closely with other parts of government responsible for regulation is a strong message from the market openness reviews.

Regulatory tools: they need to be deployed more effectively and creatively

The use of regulatory tools to advance regulatory quality can be more effective. The reviews suggest that the tools are reasonably well developed in principle, but less well deployed in practice. Yet there is a helpful and growing interest in the link between regulatory quality processes and actual regulatory performance, and in *ex post* evaluation. The evidence of the reviews confirms that there are six key areas: administrative simplification, RIA, transparency and communication, alternatives to regulation, compliance and enforcement, and tools for promoting administrative justice and accountability. The most used regulatory tool still appears to be administrative simplification. Important as it is, this also underlines the relative lack of development of the other tools. Even in the area of administrative simplification success appears to be mixed, with burdens continuing to rise in some countries.

RIA is central to the development of high quality regulation. But the reviews show that its effective implementation is a big challenge for most countries. A compelling message from the reviews is that competition and market openness perspectives are still very weak components of RIA. The effective deployment of RIA clarifies the connection between a policy goal and the rules or regulatory framework for meeting the goal, and ensures that the regulatory framework helps to meet the policy goal in the most efficient (least cost) and effective way. Though progress has been made on best practices for transparency, it is also a growing challenge in an increasingly complex political and institutional environment, but one that needs tackling, not least for the benefit of new market entrants and international market openness.

The relative lack of use of alternatives to regulation in most countries, apart from in the environmental field, underlines a relative lack of progress in the evolution of an adaptable and creative regulatory culture.

The dynamic nature of high quality regulation: not yet fully assimilated

The regulatory quality agenda is not just about "one-off" regulatory reforms. Yet some features of the current agenda – initiatives to liberalise entry into professional and services markets, or easing administrative burdens imply this. Regulatory quality is not just work-in-progress which will come to a clear end at some stage in the future: it needs to work with the grain of ongoing developments. Specific reforms are important, but only part of a much wider picture. Establishing, integrating and justifying regulatory policy as a permanent fixture within the broader governance agenda and ensuring its contribution to the continuous structural adjustment of economies and societies still have some way to go.

The sectoral reviews underline an important related point: the time lag between starting a reform process and seeing results, if only in terms of identifying regulatory approaches that work. Countries are engaged in a continuous process of adjusting and developing their regulatory regimes to match changing objectives and current understanding of what works and what works less well.

The international dimension: a growing issue, not just in the international trade context

International institutional coordination is a growing issue, as policy makers and regulators seek or need to work within broader institutional contexts. The EU is perhaps the most obvious current example of an international dimension to policy and rule-making

Box 1.2. **The regulatory framework for EU countries**

Perhaps half or more EU member country rules now come from Brussels. The EU is also shaping whole regulatory regimes. The single EU market agenda involves a mix of deregulation and market opening alongside rule harmonisation so that goods and services can move freely within the EU/EFTA region. The coverage is wide. It includes product markets (such as cars), professional and other services, and horizontal policies such as state aids, public procurement, and competition policy as well as social and environmental issues. The EU plays a prominent role in the reform of network industries (telecoms, energy, rail, posts, etc.) where it usually sets *de minimis* regulatory requirements such as the nomination of an independent regulatory authority, and the separation of competitive from non-competitive activities. The EU's common external trade policy is another large area of relevant work.

The single market programme has been a major driver of deregulation and regulatory harmonisation. It has helped to open up economies and promote trade and investment flows. EU rules have often helped to enhance social, environmental, health and safety, and consumer interests. At a broader level the EU has helped in the development of the concepts of proportionality and subsidiarity in the application of rules.

The EU also generates an increasing number of rules, which confronts it with the same rule inflation problem as its member states. The EU authorities are aware of this but (reflecting the EU policy-making process itself) it is an issue that needs to be tackled from both ends: efforts from Brussels, combined with efforts from member states too. Influencing the EU decision-making process, consulting with and informing the business community and other interested parties, effective implementation and transposition of EU rules, avoiding confusion between national and EU laws, and coordination with national sector regulators, are issues for careful management.

within which national authorities need to work (Box 1.2). APEC is another type of international framework in which national authorities seek to share experience and discuss common problems. Problems with a strong regulatory dimension that do not respect national boundaries (such as avian flu) are becoming more widespread, a side effect of globalisation and greater mobility.

Political commitment, regulatory culture, and communication

A high level of visible, reinvigorated political commitment to the development of effective regulation will be essential to maintain progress. The need for much deeper cultural change within administrations to raise consciousness of regulatory quality and to strengthen competences such as economic techniques for CBA is a linked issue. This will not happen organically: concrete measures such as training of civil servants have been identified by the reviews as necessary. Building public awareness, not least through more effective communication on regulatory issues, is an important ingredient for the further development of constituencies that will support the regulatory quality agenda and well-grounded policy making.

Notes

1. The 2002 OECD report *Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance* noted that "In essence, RIA attempts to clarify the relevant factors for decision-making. It pushes regulators toward making balanced decisions that trade off possible solutions (including the decision to do nothing) to specific problems against wider economic and distributional goals. Far from being a technocratic tool that can be simply 'added on' to the decision-making system by policy directive, it is a method for transforming the view of what is appropriate action, indeed what is the proper role of the State. Experience makes clear that RIA's most important contribution to the quality of decisions is *not* the precision of the calculations used, but the action of analysing-questioning, understanding real-world impacts, and exploring assumptions. Significant cultural changes are required to make such analysis genuinely a part of increasingly complex decision-making environments" (p. 47).
2. An example is the need to balance health and safety concerns against cheaper drugs and consumerchoice. A broader example is the interaction between product and labour market policies: product market policies and regulation can impact employment rates.
3. For example German electricity prices fell after market opening as hoped for, but environmental taxation to support renewables pushed them up again.
4. The term "regulatory reform" is avoided as far as possible, in order to underline the shift in thinking that has taken place over the last few years which emphasises a continuous process rather than a series of *ad hoc* reforms.
5. Defined broadly in terms of those activities which are funded by public expenditure, though as the text goes on to explain the precise definition is linked to issues such as the extent of private participation in publicly managed sectors.
6. "Surveillance of Public Expenditure: Synthesis of Findings in EDRC Countries". Economics Department Policy Committee, Working Party No. 1 on macroeconomic and structural policy analysis (2003).
7. In some parts of Europe, State ownership has traditionally been seen as the best way to manage a wide range of activities, some of which may be deemed commercial activities that could be carried out in a competitive environment under private ownership. As well as services such as health and education, the range of activities is likely to cover the network industries which are often deemed to have public service characteristics, but also industrial activities such as cars and aerospace. Though the extent of State ownership has declined significantly in Europe over the last decade or so, it remains extensive in some European countries, and continues to generate debate. An ongoing debate in Norway for example, opposes two very different views. Can the private sector be trusted to deliver important public services? Or should the State, counties and municipalities which have been trusted in the past continue to be directly responsible?
8. Competitive neutrality frameworks have been set up in a number of countries. They cover issues such as neutralising the potential advantages of State companies, removing subsidies and preventing cross subsidies, ensuring that State assets are not undervalued in initial balance sheets, neutral taxation, setting performance targets, and removing State guarantees.
9. Defined in the market openness analysis as "discernable patterns in regulatory decision-making informed by the collective experience across the OECD".

Chapter 2

Competition Law and Policy in the Regulatory Context

Competition policy has been, and remains, an important driver for reform in many countries

There is clear evidence of the positive contribution of product market reform and competition to economic performance. Competition law and policy have a key role to play in this.

The link between competition policy and major reform goes back a long way. In some cases, such as the US, and Germany after 1945, the link was established decades ago. Competition law and policy have been integrated into the fabric of their governance and value systems, reflecting a strong and continuing cultural commitment to its general importance as a driver of the economy.[1] In some other countries, such as the Netherlands, Hungary and Finland, the establishment or development of competition law and policy has been a driver of major reform aimed at deregulating highly regulated economy. Competition law and policy have been central building blocks for the development of market economies in the transition countries. Australia provides a different and powerful example of comprehensive competition-based reform, which goes beyond the relatively simple objective of deregulation to review laws and regulations in order to eliminate unjustified anti-competitive effects (Box 2.1).

The OECD Principles give competition policy an important role

The 1997 (and 2005) Principles (Box in the introduction) give competition policy a prominent place. There is a strong presumption in favour of competitive-market solutions to problems in so far as other policies should be pursued only through means that distort competition as little as is necessary to achieve them. The fourth of the 1997 and 2005 Principles, "to review and strengthen where necessary the scope, effectiveness and enforcement of competition policy" specifically addresses competition policy (Box 2.2).

Eliminating sectoral and other gaps: testing the public interest basis for special treatment

The first specific point of the competition recommendation underlines the scope that competition policy should have in the rule-making process. Examining sectors and practices that are exempted from the coverage of competition law involves asking why policy, reflected in regulation, should tolerate or prefer monopoly or collusion. What is the process for considering exemption from otherwise applicable rules of competition law based on other policy considerations? Is this done by the same institutions and processes that apply competition law, or by others? Exclusions and special legal or institutional regimes reflect a balance between competition policy and other policies and goals. Is this balance being achieved?

There is a need for realism about how much remains to be done. For the most common regimes, however, the gaps are not wide and there are some plausible public interest arguments to support special treatment.

Box 2.1. **The Australian competition policy review**

Australian governments have undertaken a comprehensive review of federal and state-level laws and regulations in order to eliminate unjustified anti-competitive effects. The programme derived from the 1993 Report on National Competition Policy. Following nearly two decades of declining economic performance, the Report found that "Australia is facing major challenges in reforming its economy to enhance national living standards". One of the challenges was "the reform of regulation which unjustifiably restricts competition".

Because competition law could not itself correct regulatory barriers to competition that stemmed from other laws, the report called for a "new mechanism": the adoption by all Australian governments of a set of principles aimed at ensuring that statutes or regulations do not restrict competition unless it is in the public interest. This would involve:

- Acceptance of the principle that any restriction of public competition must be clearly demonstrated to be in the public interest.
- Subjecting new regulatory proposals to increased scrutiny, with a requirement that any significant restrictions on competition lapse after a set period, unless re-enacted after scrutiny through a public review process.
- Subjecting existing regulations imposing a significant restriction on competition to systematic review to determine if they conform with the first principle, and thereafter lapsing within no more than five years unless re-enacted after scrutiny through a further review process.
- Ensuring that reviews of regulations take an economy-wide perspective to the extent practicable.

A Competition Principles Agreement based on this was formally agreed and set in motion in 1996. Most of the process has now been completed. Most of the rules identified as containing competition restraints have been reviewed. The policy appears to have established a culture of rigorous justification for new business regulation too.

Thorough reform of labour and financial markets and tax policy as well as competition policy has strengthened Australia's economic performance. The OECD's Economic Surveys of Australia link these reforms to growth in output, income, employment and productivity.

Box 2.2. **The 1997 Principles: specific recommendation on competition policy**

Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy:

- Eliminate sectoral gaps in coverage of competition law, unless evidence suggests that compelling public interests cannot be served in better ways.
- Enforce competition law vigorously where collusive behaviour, abuse of dominant position, or anticompetitive mergers risk frustrating reform.
- Provide competition authorities with the authority and capacity to advocate reform.

General exemption principles

Exemptions from the coverage of competition policy may result from deliberate decisions and compromises in the design of the competition law itself, but more often they result from other legislation. Each gap or exclusion means in effect that some other policy is considered more important than competition.

The laws or practices of all the OECD countries reviewed include some general principle of regulatory compulsion or authorisation, which exempts conduct that is required or authorised by other government authorities. This may be in the competition law itself, or it may result from the practice of the courts. Under a common principle of interpreting statutes, a competition law is considered a law of general application, but particular laws or special laws that are inconsistent with the general law create exclusions from it.[2] In short, a common general principle is that competition law does not have priority where there is a conflict with other laws. Federal countries that defer to local government authority may permit wide-ranging exemptions, implying that competition is considered less important than constitutional principles of federalism and respect for local government prerogatives. The application of competition law to local levels of government in unitary States is also sensitive. Yet local decisions may authorise non-competitive private conduct, involve actions such as denying licences which prevent market entry, and local government operations may displace more efficient private sector providers.

In nearly all OECD countries, the competition law only applies to the commercial operations of State related entities.[3] The usual pattern is illustrated by Mexico, where State-related monopolies are still subject to the law's requirements related to behaviour in other markets, especially as regards abuse of dominance. Unfair competition is easiest to identify where the government operation is an ordinary commercial service. More typically, such activities are connected with a public service. Separation of the commercial elements has been recommended in the reviews, the aim being to prevent or correct market distortions that result from government subsidisation of government commercial activities. State aids are another more direct form of government subsidisation in which competition law may have a role. Compliance with rules about public procurement and tendering is also sometimes overseen by competition authorities, as this is linked with the common competition problem of collusive bid rigging.

Sectors with special treatment

Special treatment for specific sectors may reflect the efficient application of competition principles, by adapting rules to industries with particular characteristics, such as the infrastructure sectors. But they may also reflect the pursuit of goals such as redistribution. Special treatment which limits competition can be taken forward under different forms, such as legal monopoly or market entry regulation. It may permit conduct that would otherwise be forbidden, such as resale price maintenance. Special treatment may also mean the involvement of a regulator or other agency. Mostly, special treatment does not confer complete exemption from all competition oversight.

The extent of exclusions or special rules for particular sectors is now fairly consistent. Some of the more common general exclusions reflect obvious public policy choices or permit joint ventures that are likely to be efficient and even pro-competitive. For example exemptions for standards-setting organisations, R&D, and intellectual property and performing rights societies permit classes of joint venture that are likely to be efficient. In

many other cases the picture is more complex. Provisions for the benefit of SMEs in competition laws[4] need careful design to ensure that the exemptions are neither too broad nor too narrow. Special treatment for agriculture which allows cooperative arrangements may be rationalised in various ways, such as the vagaries of the weather. It raises an issue, though, where a cooperative for primary production can also monopolise an important end product market. In the financial sector, banking regulators examine mergers for compliance with prudential standards. Services and professions are often permitted to exercise self regulation outside the reach of the competition law, and these arrangements need to strike a balance between competition and consumer protection. Special rules for publishing, media and performing arts, set up for various reasons from the promotion of cultural diversity to the protection of consumers, may call for justification to show that there are special characteristics of such products. Some special treatment has historical roots, reflecting national policies and perhaps also pressure from interest groups.

RIA style analysis would be a way of assessing the purpose and effect of special treatment, asking whether it serves a compelling public interest that could not be achieved another way. This has rarely been attempted.

Sectoral regulators

The important related issue of sectoral regulators and their relationship with competition law and institutions is covered in Chapter 5.

Vigorous enforcement: this needs careful attention when competition policy substitutes for regulation

The relevance of the second specific point of the competition recommendation is that competition law protection can substitute for regulatory protection. But for the "substitution for regulation" approach to be credible, enforcement needs to work well.

In practice, issues over independence in the regulatory context have mainly arisen with respect to complex structural cases of monopoly, privatisation, and mergers. This includes, notably, former monopoly infrastructure sectors, which can often raise sensitive policy issues. Where structural matters have industrial policy implications, enforcement and intervention usually co-exist, and many countries have an explicit provision for ministerial intervention in merger cases, which makes the process quasi-regulatory. In a few countries, decisions about mergers are the government's responsibility, or it may have discretion whether to refer a case to the competition authority for review. There may be powers to reverse a competition authority's decision, or invoke other policy goals in order to override competition-based decisions or recommendations. These mechanisms reflect the fact that issues of balance with other policies arise, linked to structures that involve several institutions with different or wider remits, not just competition authorities and their remit to enforce the competition law. Abuse of discretionary intervention is, however, a potential difficulty. Transparency of decision making is the best way to counter this problem.

Are sanctions strong enough to deter anti-competitive conduct? There has been a clear trend towards stronger financial penalties against hard core cartels, but much remains to be done. Fines may still be a small fraction of the likely economic gain from violations. Very few countries impose sanctions on individual decision makers. Where sanctions are too low to deter violations, enforcement is not yet effective enough for competition policy to prevent anti-competitive conduct that could frustrate reform.

Box 2.3. **Promoting the independence of competition authorities and competition processes and decisions**

Institutional arrangements – notably the link with ministries – play an important role, and these vary across countries. Some competition agencies are deliberately placed outside the structure of ministries, and a few have the status of ministries themselves. Where there is a closer link with ministries, this is normally associated with some special recognition for independent decision making.

Transparent and well-conceived appointment procedures are also important. Again, the situation varies across countries. In presidential systems the President normally makes the appointment, based on a nomination by the government or subject to legislative approval. Ministers may make the appointment in other countries, a system likely to be perceived as less independent, though counterbalancing checks such as a professional applications procedure may be set up. Protected tenure is as important as transparent appointment.

Control over resources (budget or personnel) supports independence, though it is difficult to find the right approach to secure this. Competition agencies rarely have complete independence. The budget of competition agencies is approved by the legislature in some cases, but is often with the relevant ministry.

There is an important distinction between policy making, investigation and prosecution, and decision making. Independence is most important for the latter. Where this is not done by an independent competition body, the courts are often key decision makers, which is helpful for independence, but less so in some cases for establishing enforcement priorities, and for an appreciation of the importance of competition issues.

Vigorous enforcement is closely linked to independence. To be effective, competition authorities need to be shielded from rent-seekers and political pressures. Competition policy, which has a core mission to prevent monopoly, is challenged by rent seeking: the greater the potential for monopoly profit, the greater the incentive to try to influence decision makers to obtain or protect that profit. Nearly all OECD countries make some efforts to secure independence for their competition authorities in the application of competition law from political or other influences. The most important issues in the promotion of independence include institutional structures, appointment procedures, and control over resources (Box 2.3). Approaches vary, and so therefore does the degree of independence.

Competition advocacy: an important task, in which the role of the competition authorities can be controversial

The third specific point of the competition recommendation highlights advocacy, because difficulties with competition-unfriendly regulation often start where enforcement jurisdiction stops. Advocacy to promote more competition friendly rules is carried out in most countries. But this may be done by the relevant ministerial policy office rather than the enforcement agency. Though an independent agency is better placed to contribute to public debate on this issue, some countries are concerned that it may undermine the independence needed for effective enforcement. The country reviews nevertheless urged a broader role where this did not already happen.

International market openness: competition principles, law and institutions make a key contribution

One of the six efficient regulation principles for market openness is the application of competition principles. The market openness reviews underline best practices from the international perspective, which pick up many of the themes from this chapter: wide ranging scope and coverage of competition laws, independence of decision-making authorities from regulatory authorities, strong competition oversight and enforcement mechanisms, timely treatment of complaints, the easy availability of proceedings from competition tribunals, and national treatment obligations that are built into national competition legislation.

The reviews note the importance of open, effective complaints procedures for challenging regulatory or private actions that impair competition or condone anti-competitive conduct. Most OECD countries have clearly established channels for handling complaints on a non discriminatory basis. Firms may take complaints directly to the regulatory authority concerned, or to the competition authority, the decisions of which may be appealed in administrative courts. While they may explore the merits of a given complaint, national competition authorities are usually not legally bound to launch full investigations unless their preliminary findings support this. Affirmative findings on civil reviewable matters are typically referred to an independent, quasi-judicial competition tribunal for decision. Most decision-making bodies can issue orders to cease and desist, eliminate the effects of infringing conduct, and impose fines. Firms may also use private rights of action to obtain redress for alleged anti-competitive conduct in the courts.

The network sectors and professional services: the application of competition tools is essential for progress to be made

The sectoral reviews highlight the different ways in which the application of standard tools for competition analysis can help to identify more effective means of tackling issues such as market power and the management of public services. Benefits of this approach would flow not just to liberalised sectors but others such as the postal sector where liberalisation remains timid. The reviews underline that the full portfolio of competition policy tools and techniques should be deployed if reform and competition is to be successful.

Ensuring that competition policy is an integral and continuing part of the rule-making framework: a challenge for most countries

The country reviews show that some countries do not yet have a very strong competition culture in which there is broad support for the principles of competition. Competition policy is not yet well grounded in the wider governance system (its business, economic, institutional, legal and political traditions). This makes all the harder to embed competition principles in the rule-making process. Where reforms are spurred by crisis, enthusiasm for further reform often wanes once the immediate need has passed, and the importance of sustaining and developing a high quality rule-making environment which integrates the principles of competition is lost.

Even in those countries where the roots of competition culture are stronger and deeper, there is usually some way to go in making a strong, continuous and practical link between competition law and policy, and the process of rule-making. To what extent does the policy and rule-making process understand and appreciate the principles of

Box 2.4. **Revisiting the 1997 Principles from the competition policy perspective**

- *Recommendation* 2 (the process of reviewing regulation). The competition enforcement agency or policy office should have a clear role in RIA and in the review of the stock of regulations. Where its assessment of a proposal or rule discloses that it is likely to have a significant effect on competition, the burden should be on the proponent (which could be the government) either to correct it or to respond to that assessment with an explanation of why it is nonetheless required in the public interest. Regulations that constrain competition would not be forbidden. But such a requirement would help ensure, through the discipline of public debate, that constraints on competition are limited to occasions where they are necessary to serve another, overriding public purpose.
- *Recommendation* 4 (sectoral "gaps" and enforcement effectiveness), and *Recommendation* 5 (deregulation). Creating different competition law regimes for different sectors undermines consistency. The approach that seems to be most effective is for sector regulators with competition policy responsibilities to apply the substantive principles of the general competition law. Variations to respond to conditions in the particular sector should be developed in conjunction with the general competition policy agency and enforcer, which should also be consulted about decisions that depend on consistent analysis and application of general principles, such as the definition of markets and the determination of the existence of market power.
- *Recommendation* 4 (sectoral "gaps" and enforcement effectiveness), and *Recommendation* 5 (deregulation). To ensure coherence and resist pressures for special interest interpretations, competition law and sector regulation to protect competition should be co-ordinated. No single type of institutional structure is prescribed. Bringing regulation of different networks together into one institution can promote consistent analysis, economise on expertise, and help shield against capture. Providing the same judicial route for review or appeal of decisions by sectoral regulators and by competition enforcers ensures that the principles are applied consistently.
- *Recommendation* 4 (vigorous and effective enforcement). The consequences of violating laws should be significant enough to encourage compliance with them. Thus, sanctions imposed against anti-competitive conduct should be sufficient to deter violations. Principles of deterrence call for setting them to be proportionate to the violators' expected gain and to the likelihood that the violation will be detected and punished. In addition, sanctions should take account of the risk of public harm from the violation.

competition policy? Is the principle of "least anti-competitive means" applied in rule-making, and if so, how and how effectively?

The way in which Regulatory Impact Analysis (RIA) is applied plays a determining role in answering these questions for individual countries. The second of the 1997 Principles recommends the systematic review of regulations to ensure that they continue to meet their intended objectives efficiently and effectively. The 1997 recommendations also imply that RIA should include a principle of "least anti-competitive means" to accomplish the regulation's purpose. Does the RIA process incorporate the need to take a view on this issue, and to take account of the constraints on competition? To what extent (if at all) are competition policy officials involved in the process? The country reviews suggest

important weaknesses. Chapter 5 takes a closer look at this, in the broader context of RIA development in OECD countries.

Taking the 1997 Principles forward: the competition policy perspective

The 1997 Principles remain sound, but expectations about their implementation should be realistic. The level of generality of the Principles is appropriately high, but they could be strengthened to assure an appropriate priority for competition values, by providing explicit roles for competition authorities and the means to ensure coherent application of competition principles (Box 2.4).

Notes

1. The US competition policy institutions are a product of the "progressive reforms" of the early 20th century, and cultural acceptance of competition as a driver of the economy and society is strong, reflecting these roots. The German competition law and its competition authority, the *Bundeskartellamt*, were centrepieces of post-war reforms, and to this day play a central role in the institutional and cultural landscape.
2. Cataloguing these exclusions is difficult because the acts which exclude are not necessarily collected in one place. Moreover, a *de facto* exclusion or exemption may result from a restriction on available remedies or even simply a policy or practice of non-enforcement in some sectors or situations, and these can be almost impossible to identify reliably.
3. The legal form and definition of State related entities is important in determining the coverage of competition law. Also, the law may prescribe competition in State related operations, but decisions about what that actually means may be made by ministries or officials other than the competition authority.
4. For example, rules that allow SMEs to achieve efficiencies together by cooperating under certain conditions.

Chapter 3

Market Openness in the Regulatory Context [1]

The 1997 Principles and the six efficient regulation principles for market openness

A reduction of barriers to trade and market openness contributes to product market performance and hence to overall economic performance and social welfare. High quality, appropriate regulation and regulatory reform have an important role to play in promoting market openness.

Six efficient regulation principles[2] have been used in the country reviews to assess how far regulation and regulatory processes support market openness:

- Transparency and openness of decision making.
- Non-discrimination.
- Avoidance of unnecessary trade restrictiveness.
- Use of internationally harmonised standards.
- Streamlining conformity assessment procedures.
- Application of competition principles.

The 1997 Principles of good regulation are all relevant, broadly or specifically, to the goal of market openness. The fifth recommendation, "to eliminate unnecessary regulatory barriers to trade and investment by enhancing implementation of international agreements and strengthening international principles", is directly concerned with the issue. The others are also for the most part relevant because market openness can be expected to thrive in a context where the rule-making process supports regulations that are efficient in terms of cost, effective in terms of having a clear regulatory and policy purpose, transparent and accountable.

Market openness and high quality regulation: mutual support

The country reviews demonstrate that policies to promote market openness and regulatory quality are mutually supportive. Although the main aim of high quality regulation has traditionally been focused on the health of the domestic economy and society, foreign as well as national stakeholders are well served by an effective domestic regulatory environment. Most of the regulatory tools and processes developed at the domestic level, such as RIA and consultation procedures, are also helpful to foreigners if they are effectively implemented. For example, administrative simplification programmes directed at reducing administrative burdens also contribute to trade facilitation and market openness (see Box 5.2).

At the same time, the global trade community is a powerful driver for moving the domestic regulatory quality agenda forward. Globalisation is a strong force for simplification and better regulatory quality, as international trade is promoted by better, simpler and fewer rules. International trade institutions and national companies broadly share a common agenda, to strengthen international trade flows and (for the latter) to sustain competitiveness in global markets. OECD countries' membership of global

institutions to promote international trade (notably the WTO) is helping to promote better domestic as well as international regulation. The market openness reviews emphasise a growing understanding of the importance of improving national regulatory environments. With the progressive removal of tariff barriers to trade, the spotlight has been falling on "behind the border" regulation and the obstacles this may present for market openness in terms of trade and investment.

Transparency and openness of decision making

Systematic public availability of information, clear, simple procedures for making and implementing rules, systematic reliance on public consultation, clear, open, effective appeals procedures, and efforts to ensure transparency in particular areas, have been highlighted by the country reviews as best practices for fostering market openness (see Box 3.1). Equal access to regulatory information, to public consultations and to appeal procedures for all stakeholders, whether foreign or domestic, is a crucial aspect of maintaining open markets. Requirements to ensure transparency are also part of multilateral trade agreements. The WTO agreements include obligations to make trade-related rules and regulations publicly available, and to inform other members *via* notifications to the WTO.

Beyond the more general issues (which are examined in Chapter 5), the market openness perspective notes the importance of ensuring transparency in standards development. Transparent standards development processes are a key indicator of commitment to market openness. Most countries have delegated responsibility for standards development to private or quasi-public standards development organisations. Independent government entities usually oversee the process. International disciplines relating to transparency in standards development, such as the relevant WTO code of good practice,[3] are often explicitly transposed in domestic instruments. These processes appear to be broadly open and transparent in most of the countries reviewed. Best practices include a rigorous approach to standards development, effective balancing of interests across stakeholders (industry, consumers and regulators), and effective consultation procedures with adequate time for comments and clear accountability for handling comments.

Another relevant issue for transparency is government procurement, which represents a major opportunity for increased international trade (see Box 3.2). In fact the issue goes beyond transparency. Despite EU directives on public procurement and a WTO Agreement on Government Procurement, which lay down basic principles of transparency, non-discrimination and equal treatment, public procurement often seems vulnerable to insider domination (conscious or not). Compliance with procurement rules may be poor and tendering processes not always used, or not very competitive. Competitive neutrality between private service providers and the municipalities' own service provider arm which may be in competition with the former also need to be reinforced, to encourage outsourcing. The regulatory framework for public procurement needs to be reinforced.

Non-discrimination

Formal commitments and regulatory attitudes

Non-discrimination still has to make a stronger mark in the consciousness of national regulatory processes, and in formal terms is largely driven by the need to respect international commitments.

Box 3.1. **Transparency and market openness**

The first core transparency issue is to know what the rules are and where to find them. This is especially relevant for new market entrants, who may be confronted not only with different regulatory content, but a different regulatory culture and administrative framework.

Information on existing and prospective rules

Existing rules must be systematically available through widely accessible channels, at minimum cost. The country reviews highlight best practice through systematic publication of detailed information using both online and traditional print media. Consolidated information about existing rules is increasingly available online, often complemented by the websites of individual ministries and others.

The availability of prospective new rules is less consistent, and approaches vary more between countries. Some countries communicate new proposals in a printed government register or bulletin, backed up by an online version with search facilities.

Consolidated databases for existing and prospective rules at subcentral levels of government remain rare.

This aspect of transparency is also greatly enhanced through well functioning enquiry points. The best of these feature skilled and knowledgeable personnel, fast turnaround times, and optimal use of technology such as e-mail auto responders.

Internet

One-stop electronic portals and gateways, designed to allow the user access to a wide variety of further information from a single starting point, are increasingly widespread. Putting information on the Web sets the scene for online consultation processes which facilitate involvement in the process and extend its potential reach to more stakeholders, and online business and citizen administrative transactions. Some countries still struggle with the effective design and management of websites.

Clear, open and simple procedures in making and implementing rules

Participation in rule-making for domestic and foreign stakeholders alike depends on clear and predictable processes which are well explained so that stakeholders can see where and how they might be involved. Codifying these processes is another best practice and many countries have done this, in some cases developing detailed written guidance too. When procedures are not followed because compliance and enforcement is weak, however, stakeholder participation will be compromised.

Clearly written rules

Progress has been difficult on this point, and large challenges remain. Some problems can spill over into trade disputes over rule interpretation. A difficult balance must be achieved from different starting points as there are wide differences in underlying national legal cultures. Rules may be tightly drafted to minimise interpretation, in contrast to a looser more performance-based approach. Paradoxically both approaches can lead to difficulties in interpreting the underlying requirement: from huge complexity generated in some prescriptive legal systems that can confuse even the authorities, to broad rules that invite problems of interpretation. Part of the best practice that has emerged involves the systematic review of existing stocks of legislation, and the rigorous vetting of new draft rules.

Box 3.1. **Transparency and market openness** *(cont.)*

Public consultation

Some countries have practiced public consultation for a long time, including "notice and comment" procedures that can start well before a rule is drafted. But even where the concept is embedded in principle, the quality of the process can vary, from countries where it is fully transparent, well-organised, highly accessible, well-timed, and with clear lines of accountability, to others where there is wide discretion over the process. Clear guidance to regulators can help to streamline approaches where this is necessary. Where there is no embedded commitment, yet, to formalised systems, informal consultations usually exist but are only partially effective in meeting the goal of ensuring that stakeholders' voices have been well heard. But informal systems may be a stepping stone of experience toward more rigorous systems, and they may also provide needed flexibility in reform efforts, as well as rapid responses, especially in small countries.

Box 3.2. **Transparency and government procurement**

Government procurement represents huge opportunities for international trade* (as well as for domestic firms). Government procurement processes involve a sequence of actions involving transparency flashpoints, from the tender announcement, its timeframe and criteria, to the criteria for evaluating bids, the procedures for challenging awards of a bid, to award of the bid to the successful firm. The evidence of the reviews shows that transparent procurement remains a challenge in many countries, though best practice has started to emerge. The adoption of an EU-wide procurement framework has pinned down a number of relevant requirements such as clear and detailed published information on all aspects of the bidding process. Some EU countries have been more successful than others in implementing these rules. Use of the Internet to disseminate information and facilitate bidding has emerged. Ensuring that the legal framework is in place on procurement is important, though not the only condition for transparency success, as implementation challenges can often arise. In some countries allegations of bid rigging, the absence of recourse for failure to respect the rules and lack of discipline at the sub-central government level have been picked. up The application of domestic regulatory quality principles is a key support for progress on procurement.

Implicit or explicit discriminatory practices against foreigners in government procurement are an issue. Although several OECD countries are signatories to the WTO Government Procurement Agreement (GPA), the quality of market access varies widely. This may be particularly true in countries where significant procurement takes place at the subcentral level not covered by the GPA. Some countries still maintain expressly discriminatory elements in their national procurement regimes.

* For example purchases by central and local government combined account for around 14% of EU GDP.

In most countries, specific commitments to the principle of non-discrimination are based on Most Favoured Nation (MFN) Treatment and National Treatment (NT), and flow from WTO membership. Responsibility for ensuring implementation of WTO agreements, including on non-discrimination, typically lies with the trade or economic ministry, sometimes complemented by intergovernmental mechanisms. Some countries make

efforts to encourage the respect of non-discrimination as a principle by national regulators, which may lack legal force but should not be dismissed as unimportant for the shaping of regulatory culture. Countries tend to be generally vigilant about implementation of WTO agreements as disrespect can be, and often has been, caught by the WTO dispute settlement system. Exceptions to the principle of non-discrimination (MFN exemptions and exceptions to NT) tend to be narrowly defined. MFN exemptions are subject to removal by a certain date, and NT exceptions are subject to a progressive liberalisation under the GATS. Overt discrimination is therefore at least disciplined by transparency, *via* notification.

Overt discrimination may be rare but there are often perceptions of *de facto* discrimination or rules that may have a discriminatory effect on foreigners. Important areas of national regulatory frameworks which can raise this kind of problem are covered in Chapter 5. They include public procurement (which may also include a measure of overt discrimination), and self regulation by industrial associations. Subtly protectionist vested interests may be at work. *De facto* discrimination may also simply result from inadequate vetting of regulatory proposals and a lack of awareness in the regulatory culture of the need to develop trade-friendly regulation.

Commitment to open regionalism

Regional and multilateral trade liberalisation are basically complementary, but this complementarity depends on how it is given effect in practice. Although there is wide support for the principle of open regional trade arrangements, some countries have been enthusiastic proponents of open regionalism, while others have only recently moved away from their traditional preference for multilateral trade liberalisation. Best practices include a high level of political commitment, willingness to multilateralise at least some of the preferences granted in the regional context, active participation in multilateral trade liberalisation initiatives, transparent management of regional agreements, and the availability of avenues for the pursuit of complaints. Although the Internet has been a significant help to transparency, important weaknesses remain, aggravated by the complexity of navigating among a proliferation of regional agreements and different approaches to them. Information is dispersed, and regional undertakings on, for example, standards-related activities can carry risks for non-parties.

Attitudes toward foreign direct investment and foreign ownership

There has been a positive general development in attitudes. Most OECD countries maintain some nationality-based restrictions on foreign investment, typically in the form of foreign ownership restrictions in key sectors such as telecommunications. Some countries also regulate investment through the use of notification and review provisions. However the mood has changed overall, from heavy scrutiny to more liberal policies seeking to attract investment in an era marked by the relative scarcity of global investment resources, and even competition to attract investment based on various incentives.[4] But liberal attitudes are not always matched by the capacity to welcome foreign investors. Red tape and lengthy procedures for example can spoil the intent. Achievements over the last few years also need to be set in the context of other issues in the regulatory environment (picked up in Chapter 5 on regulatory quality) that may mitigate the enthusiasm of foreign investors for settling in a new market.

Avoidance of unnecessary trade restrictiveness

The examination of this principle in the reviews underlines the importance of encouraging a fundamental evolution in regulatory culture to assimilate the trade perspective. This, generally, has not yet been achieved.

Regulatory policies, tools and institutions may need adjustment to accommodate the market openness perspective. The principle of avoiding unnecessary trade restrictions, together with that of competition, is closely interwoven with the domestic regulatory quality agenda. Rules and a regulatory environment which avoid unnecessary trade restrictiveness are also generally good news for domestic stakeholders too. But national regulatory environments are only sometimes under an obligation to take account of trade restrictiveness, and even if they are, the regulatory culture may not yet offer effective support for the formal principle. Key issues picked up under the market openness perspective include the effective deployment of RIA, and the reduction of administrative burdens on business.

Many OECD countries rely on regulatory impact analyses to avoid unnecessary trade restrictiveness. RIA can provide policy makers with information that enables them to choose among the array of equally efficient regulatory alternatives available for attaining a particular regulatory objective the one that causes the least distortions to trade. Administrative simplification is crucial from the market openness perspective, because even when international players in principle encounter the same administrative requirements as domestic players, the administrative burden deriving from it can be higher in their case. Firms that operate in a variety of markets will find it more difficult and costly to collect information, understand and comply with administrative requirements that differ from country to country.

The simplification and harmonisation of international trade procedures offers another important tool for governments to minimise unnecessary trade restrictiveness. Procedures relating to customs clearance can often impose significant delays and costs on traders. Regulatory reform covering this area intends to reconcile the efficient pursuit of different social and economic objectives (such as revenue collection, health and safety protection and prevention of illegal practices) with a simplified way of doing business, streamlining documentary requirements and accelerating product clearance.

Better communication between trade and regulatory officials needs to be promoted by senior levels of government and the political leadership. Trade policy bodies are more likely to weigh in during policy development, rather than later in the day-to-day business of rule-making. More proactive involvement at all stages, especially through RIA, might be expected to make a positive difference in ensuring that the trade perspective is taken into account. Working level relationships between trade and regulatory authorities (including competition authorities and sub-central levels of government) could also be strengthened. Better use of existing coordination mechanisms may need to be supplemented by the creation of new fora. This closer involvement in regulatory processes would also help regulatory culture to evolve. For example, concerns that market openness may not sit comfortably with other public policy goals such as health, safety and the environment can be explored and fears allayed, by examining areas where the former has actually helped the latter.

The market openness chapters in country reviews identified a further, specific issue linked to this principle. Practical capacities for trade-friendly regulation may be compromised by national legal frameworks that do not authorise alternatives to traditional

"command and control" rules such as performance based regulation. The WTO Technical Barriers to Trade (TBT). Agreement states that "wherever appropriate, members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics". In other words parties should have flexibility to meet a regulatory objective in any way that achieves the result, without being told exactly how they have to do it. They cannot yet always exercise this flexibility.

Use of internationally harmonised measures

There are two aspects: reliance on international standards as the basis for domestic regulations, and acceptance of foreign measures as equivalent to domestic measures, even where these may differ, as long as such measures meet the underlying regulatory objective.

WTO rules (the TBT Agreement and the SPS Agreement) exhort members to rely on relevant international standards as the basis of domestic regulations wherever possible and appropriate. This may, for example, be given effect by national standards bodies setting standards that directly transpose EU standards, which themselves closely mirror ISO/IEC standards. The lack of systematic data collection and monitoring for international standards is a recognised challenge for most OECD countries, making overall progress in their use hard to judge. Progress appears to range from fair to excellent. Some countries have made important efforts to move the process forward, for example by setting up special monitoring agencies, regulatory innovations to speed up adoption of international standards, and periodic review of existing standards. All the reviewed countries are active participants in the development of international standards.

The WTO TBT also requires members to give positive consideration to accepting as equivalent the technical regulations of other members, even if these regulations differ from their own, provided they are satisfied that the regulations adequately fulfil the objectives of their own regulations. Some countries have specific procedures now in place for this, but experience remains limited. The EU is a special and positive case, with its New Approach and Global Approach developed in the context of the single EU market. If manufacturers fulfil certain "essential requirements" defined in EU law, this enables the acceptance of foreign measures so long as they are "equivalent", the test being whether they meet the essential requirements. This system replaces the full harmonisation of divergent rules among member states. It is not without practical implementation challenges on the ground, and relies on close relationships between relevant officials as well as broad systemic compatibility. It may however serve as a useful general pointer for broader international efforts to give effect to WTO obligations. In several other countries there are national efforts undertaken to encourage 1) the adoption of regulations based on harmonised measures 2) monitoring of progress in the development and adoption of international standards and 3) provision of incentives for regulatory authorities to seek out and apply appropriate international standards. International government-business dialogue on the issues is also promising.

Streamlining conformity assessment procedures

Approaches to streamlining conformity assessment, so as to avoid unnecessary duplication of requirements, vary considerably across the OECD. This area is, for generally good reason, highly country and situation specific.

The EU approach combines a prescriptive regime with significant flexibility. The Global Approach sets out detailed procedures for establishing conformity with essential requirements, including criteria relating to the independence and quality of certification bodies, and the modalities for mutual recognition and accreditation. It offers flexibility by building in a range of alternative procedures that can be used, depending on the situation, including suppliers' declarations of conformity (self declaration), verification by an independent third party, and full product quality assurance. Once it is found to be in conformity, a product carries the CE marking and can be freely marketed across the EU. Some other OECD countries show that a rules-based regime may be unnecessary: in the US a regulator must decide as part of the regulatory decision-making process whether an attestation is necessary at all, or may rely on other instruments such as spot checks. Most reviewed countries have sought to enhance market confidence for the efficient operation of conformity assessment by setting up accreditation mechanisms, under which domestic or foreign bodies wishing to offer conformity assessment services must be accredited.

Mutual recognition of the results of conformity assessment procedures has been a high growth area, and the subject of considerable negotiations. A Web of mutual recognition agreements is currently under negotiation or at the implementation phase. It can work well where there is a basic complementarity in regulatory approaches, a necessary ingredient of success. It also depends critically on successful implementation, which requires a long further phase of confidence building and information exchange.

The use of suppliers' declarations of conformity seems to be emerging as a particularly promising approach by offering greater flexibility in meeting conformity assessment requirements. Government regulation on how to achieve this is replaced by free choice for firms between different paths, for example "self-declaration" based on in-house testing. This approach relies heavily on a mix of professional integrity, mutual trust, and a willingness by the firm to accept full risk if problems arise.

Application of competition principles

Anticompetitive practices of private firms can present difficulties for the efficient functioning of international markets. Some of these practices include hard core cartel conduct, abuses of dominant position, or attempts to monopolise a given market. These activities can restrict market access by seriously undermining the efforts of firms to enter new markets. For this reason, a commitment to sound competition principles is crucial in providing the appropriate conditions for genuine market openness.

This principle of efficient regulation has been tested in the reviews against two criteria: overall commitment to the vigorous application of competition principles from an international perspective, and in particular through the existence of open, effective complaint procedures, and (as an outcome of the former) effective access to domestic economic activities. The first is examined more closely in the competition policy chapter, as the vigorous application of competition principles is central in the domestic context as well as for trade.

Principles need assessment in terms of what happens in practice. Long established but little contested private practices, such as private cooperative arrangements and channels for distribution, may present particular difficulties for foreign firms seeking to sell into new markets. Industrial or trade associations, especially where the government has delegated them some regulatory powers, can raise issues: their workings can be opaque, and there is a risk that they may distort competition.

Regulatory Practices for fostering the six principles of efficient regulation

Collective OECD experience points to emerging best practices across the six efficient regulation principles (Box 3.3). Length of experience with regulatory reform, underlying political commitment, awareness and expertise of the regulatory authorities, effective trade advocacy, and rigorous oversight and implementation are key factors for progress. The principles that also cover issues relevant to domestic stakeholders, such as public consultation, are likely to find political support more easily than trade-specific issues such as mutual recognition of equivalence, because of expected domestic benefits.

Some countries have made significant progress in avoiding unnecessary trade restrictiveness in domestic regulation, with developments such as better consultation procedures, and groundbreaking use of the Internet to disseminate information and consolidate service delivery. Some have also made considerable progress on the trade-specific side, such as commitments to open regionalism and the establishment of liberal investment regimes.

But significant challenges remain. The scope for further promotion of explicitly pro-competitive legislation is highlighted in the trade context by the fact that regulatory culture often stops short of doing more than ensure respect for international obligations. Communication and collaboration between trade policy officials and domestic regulatory authorities is often a problem, highlighted by the relative absence of the former's influence on RIA. Implementation of regulatory policy and effective deployment of regulatory tools is a key challenge; this is also the broad conclusion of the regulatory quality reviews. The market openness reviews raise particular concerns about inadequate training of regulators, and weaknesses in challenge and oversight functions higher up the system.

The validity of the six principles is reaffirmed by the reviews. They are interrelated: for example RIA may be discussed under both the principles of transparency and of avoidance of unnecessary trade restrictiveness. Also many issues, for example public procurement, require the application of more than one principle: principle-by-principle analysis in isolation needs to be avoided. There is scope to refine the principles so as to better capture the essence of good regulatory practice. Closing the gap between principles and practice remains a work-in-progress. The trade perspective emphasises the need to pay attention to broad and systemic issues for the improvement of regulatory quality in the trade context, such as building public awareness of the benefits of market openness, and improved training for regulators.

Taking the 1997 Principles forward: the market openness perspective

The country reviews and thematic studies endorsed the soundness and the validity of the 1997 Principles from a market openness perspective. The elimination of regulatory barriers to trade and investment through continued liberalisation, and the consideration and better integration of market openness throughout the regulatory process remain important tasks. The practices that the 1997 Principles identified, namely the strengthening of international rules and principles to liberalise trade, the reduction of barriers arising from divergent and duplicative requirements, the recognition of equivalence, and the development of and reliance on international standards, also remain valid. In addition, since the mid-1990s, some key elements and practices have became clearer or developed further that make the revision of the 1997 Principles necessary. Box 3.4 presents these new elements.

Box 3.3. **Illustrative good regulatory practices for fostering market openness**

- *Transparency and openness of decision making*
  - Systematic public availability of information
  - Clear, simple procedures for making and implementing rules
  - Systematic reliance on public consultation
  - Clear, open, effective appeals procedures
  - Efforts to ensure transparency in particular areas
- *Non-discrimination*
  - Narrow exceptions in practice (overt discrimination such as nationality-based restrictions)
  - Contestable markets for government procurement
  - Explicit lead responsibility for ensuring implementation of non-discrimination and other WTO obligations
  - Extent of awareness and efforts to avoid discriminatory effects in regulation (*de facto* discrimination)
  - Demonstrated commitment to open regionalism
  - Liberal policies toward foreign ownership and investment
- *Avoidance of unnecessary trade restrictions*
  - Use of RIA with due attention to trade effects when making regulations
  - Demonstrated efforts to favour trade-friendly regulatory approaches
  - Simplification of administrative requirements
- *Use of internationally harmonised measures*
  - Reference to international standards as the basis of national standards and domestic regulations
  - Systematic monitoring of efforts to use international standards
  - Acceptance of foreign measures as functionally equivalent
- *Streamlining conformity assessment procedures*
  - Demonstrated flexibility towards use of alternative approaches for avoiding duplicative conformity assessment procedures
  - Establishing market confidence through accreditation mechanisms
  - Efficient functioning of conformity assessment bodies, possibly on a competitive basis
- *Application of competition principles*
  - Open, accessible complaint procedures for challenging regulatory or private actions which may impair market openness

Box 3.4. **Revisiting the 1997 Principles from the market openness perspective**

With the deeper integration of national markets as a result of globalization and of progress in trade and investment liberalization, domestic regulations have an increasing impact on international economic relations. Domestic regulations are also an important determinant of a country's international competitiveness in the global economy. Under these circumstances, there is a strong need to better integrate the consideration of market openness perspectives in the design and implementation of regulations.

In the process of designing new or reviewing existing regulations, RIA can be used as a tool to test different regulatory solutions concerning their effect on market openness and on international competitiveness.

Enterprises with international presence have to face the challenge and the additional costs of meeting distinct national regulatory requirements. In order to reduce the disadvantages for traders that may arise from regulatory diversity, countries should define criteria for accepting foreign standards, measures and qualifications as equivalent to domestic ones when they pursue the same regulatory objective.

The recognition of equivalence of other countries' conformity assessment, licensing and certification procedures and results greatly facilitates trade in both goods and services. Countries can apply a variety of approaches to achieve this objective, depending on the circumstances. One method is to formalise the process through mutual recognition agreements (MRAs) signed by two or more countries on the recognition of equivalence. Progress towards a more efficient system can also be made through the recognition of supplier's declaration of conformity, unilateral recognition of equivalence, or through voluntary arrangements between conformity assessment bodies in different countries.

In those cases when the recognition of equivalence is not possible, foreign producers and service suppliers wishing to demonstrate equivalence locally should be provided with transparent and accessible avenues to do so.

Notes

1. This chapter and the later chapter on regulatory quality are closely related in important areas. See especially Boxes 5.2, 5.4 and 5.5 in Chapter 5 on regulatory quality.
2. Previously identified by the Trade Committee.
3. The WTO TBT Annex 3 Code of Good Practice for the Preparation, Adoption and Application of Standards.
4. Reverse discrimination has even happened, under which foreign parties enjoy additional advantages over domestic firms.

Chapter 4

Sectoral Reforms in the Regulatory Context

The sectoral reviews considered sectors that have specific and often difficult characteristics, for which regulatory regimes and reform need to be carefully tailored. They concentrated mainly on electricity, and to a lesser extent gas. The professions, the postal sector, road and rail services, civil aviation, ferry services, hospitals and labour market institutions have also been covered in some of the reviews.

Regulatory reform in electricity and gas

Prior to electricity reform, most countries were served by a vertically and horizontally integrated electricity industry. There was no competition in the supply of electricity to individual end users, and in most countries the integrated entities were owned by the State or local governments. The mix of governments' policy objectives for the electricity sector is usually broad, with security of supply, environmental objectives and efficiency often being the main targets, but with each country applying its own emphasis. The desire to promote efficiency through competition in electricity supply is, however, an objective that the reviews highlight as a strong shared theme. The reviews mainly considered the issues involved in the successful development of competition: market power, concentration in generation, access to essential inputs (notably, networks and fuel sources), competitive neutrality, stranded costs, efficient use of and investment in the transmission network, demand-side reform, and reform of end user pricing. Regulatory institutions were also identified as key. This issue is picked up in Chapter 5 on regulatory quality which reviews the establishment of independent regulators.

Market power in electricity markets, and concentration in generation

The reviews underline a recurring concern on the path to competition: reforms have not been sufficient to mitigate all market power. It seems that electricity markets are prone to market power, because they have special features.[1] Short term demand is highly price inelastic, and supply becomes highly price inelastic once physical capacity constraints are approached. Each point in time represents a distinct product market, and for each of these only some generation sources will be able to meet marginal demand. Transmission constraints can aggravate the problem. Standard market concentration measures do not capture the situation. But the tools and techniques of competition policy are essential for developing approaches to counter the problem. Using competition policy analysis suggests six key areas for attention if market power is to be constrained: increase the scope of the product market, increase the scope of the geographic market, increase the sensitivity of demand to price, decrease concentration among existing suppliers within the relevant markets, increase the size and sophistication of customers, and reduce barriers to entry.

High levels of concentration in generation markets are a common problem, often arising from the inherited pre-reform concentrated industry structure. The simplest answer to the problem is horizontal divestiture of generating assets into several companies, and this has been done in several countries. It is preferably done at the start of reform, as later divestiture of private firms is awkward. Regulation is a much less effective

answer than structural remedies, but if the latter is difficult price or capacity caps may be of limited help.

The natural gas reviews suggest that the concentration problem is even more acute in this sector. Most (not all) OECD countries rely on imports from a limited number of countries, through a limited number of pipelines. For these countries, effective competition requires either third party access to pipelines or redeployment of import contracts to independent gas suppliers. Competition between the companies holding the contracts may also be encouraged, for example by allowing importers to sell outside their region.

Access to essential inputs

A further requirement for effective and sustained competition is access by generators to essential inputs. This too was a recurring theme of the reviews. The most important is non-discriminatory access to the transmission and distribution networks, for which vertical separation (of the grid from generation and supply) may need to be envisaged. Vertically integrated incumbents have an incentive to deny or restrict access to rivals. The reviews note that discrimination can be subtle, for example the provision of information or the way capacity is allocated. Again, regulation appears to be a poor substitute for disaggregation, involving substantial and costly efforts, as well as considerable intrusion in company affairs.

Access to fuel sources for new generation, especially natural gas, appears to be almost as important as access to the grid. In many countries the range of fuel sources is limited. Problems of discriminatory access are likely to arise if access to an essential fuel source is controlled by a firm that also competes in the electricity market. Access to gas transmission capacity and Liquefied Natural Gas (LNG) terminals may be a significant constraint on new generation entry. Access to gas storage may also be an issue. Obtaining planning permission may be difficult too.

Competitive neutrality, and stranded costs

Partial or complete State ownership of incumbent electricity supply entities remains common across the OECD. Competition in this context can emerge in various ways: it can be promoted or emerge via divestiture, new market entrants, or supply into other utilities' markets including cross-border trade. The coexistence of both private and public firms in the same market raises issues about the "level playing field". Incumbents may be either advantaged or disadvantaged by the new framework because of different treatment, but the former is probably more common. For example the accounting rules for State enterprises may be looser, there may be preferential tax arrangements, concessions and licensing may be more generous to incumbents, a lower rate of return may be allowed, and they may have privileged access to cheap generation such as domestic coal. The broad solution is to ensure that State entities competing in a market with privately owned firms are, as far as possible, subject to the same rules, taxes and capital market pressures as privately owned firms. The reviews note that competitive neutrality frameworks have been set up in some countries to address this.

Incumbents are also sometimes disadvantaged *vis-à-vis* their new entrant rivals. Historic pre-reform obligations such as long term power purchase agreements which commit the incumbent to purchasing power at above market prices give rise to "stranded costs". Long term "take or pay" contracts in the gas sector may have the same effect. Indeed stranded costs may make governments think twice about liberalisation because of

worries about the solvency of incumbents. The reviews note the adoption of a number of solutions, for example making new entrants share the burden.

Efficient use of and investment in the transmission network

The capacity of transmission networks has a critical influence on the geographic scope of electricity and gas markets. In electricity, two regions are in the same geographic market only if there is a transmission link between those regions and that link is not capacity constrained. Constraints can be very short term, depending on fluctuations in demand, but there may also be long term structural undercapacity. Expansion of transmission networks (capacity, interconnections) is often key to promoting a sound basis for competition, and mitigating the market power which can be exercised when there are significant constraints. Incumbent firms, however, often do not support expansion, as it is not in their interest to help the competition. Also, major investments may benefit some market participants and hurt others.[2] Strengthening international interconnections may be a particular issue, as these were built to support reliability, not competition. Putting in place mechanisms to ensure timely and efficient levels of investment in transmission networks is a challenge, for which solutions are still "work-in-progress".

The efficient use of the transmission network capacity that already exists is just as important as the additional investment issue. Regulation needs to strike the right balance. The right short term signals need to go to generators and consumers on how much to produce and consume, but the right long term signals are also needed to guide location decisions by generators and consumers. This is another complex "work-in-progress" issue. There are complications in achieving the most efficient cost-reflective pricing for electricity, because flows in transmission lines are linked in a complex way to the manner in which electricity is injected and withdrawn at different points, and the wide and rapid variations in injections and withdrawals. Some existing pricing mechanisms can limit competition though. In particular, transmission tariffs which depend on distances (and so do not reflect electrical losses or congestion) can hinder competition from distant generators. A further complication is that electricity and gas transmission are close substitutes,[3] so their relative pricing affects the location of generators. Maximising efficient decision making implies pricing transmission for both energies as closely as possible to true economic cost.

Demand side reform

An important lesson of the reviews is not to neglect the demand side. Reforms should encourage customer choice, promoting the scope for seeking out the lowest price/highest quality supplier. Allowing consumers to choose their supplier is a necessary counterpoint to supply side market opening. The reviews note progress with customer choice, some countries having opened the market to all customers, others phasing it in. Until there is widespread choice, incumbents with captive customers can be put under an obligation to seek out the cheapest source of power, encouraging competition between generators. Where there is full consumer choice, obstacles to switching suppliers may still be an issue and need addressing.

The demand side is also important for encouraging consumer responsiveness to price changes. Traditionally this does not happen, with consumers paying an electricity tariff that is independent of the spot price for electricity. This inelasticity enhances the scope for market power, increases the volatility of electricity prices, and raises the total costs of

Box 4.1. **Reliability and environmental protection: other goals for the electricity sector**

Reliability

Prices are the basis on which most markets signal the need for new investment, and the way in which capacity is rationed when supply is tight. Electricity spot prices play this role to some extent, but to work, the spot price needs to be able to respond quickly to changes in supply or demand. There are technical features of electricity markets (discussed in the main text above) that raise issues, and political constraints may limit how high prices are allowed to rise. Explicit pricing of reliability via higher prices and a commitment to maintain supply, and its counterpart, providing scope for some consumers to be "interruptible" in exchange for a lower price, can help. Efficient pricing of transmission for investment is also helpful to ensure appropriate price signals through the supply chain. Transmission investment is not only good for competition, but has a basic role in ensuring security of supply. In this particular context, the reviews note that the move away from rate of return regulation raises issues of how to sustain incentives for reliability, as a rate of return approach does at least give firms a powerful incentive to invest (for the wrong reason though: costs can be passed through to customers).

Environmental protection

In some countries the issue has had a major influence on the shape of reform, and a common theme was how to meet environmental objectives with minimum impact on competition. Market based mechanisms such as "green certificates" for renewable energy were identified as important.

supply.[4] Time of use pricing and interruptible supply contracts for consumers who want them are solutions that allow prices to track spot prices more closely.

Reform of end user pricing

Price distortions came up in many of the reviews. End user prices for electricity are not liberalised overnight, but are commonly regulated, at least for the prices charged by incumbents. But setting these prices too low can discourage market entry. Also, if the industry as a whole is to break even, low tariffs for some customers must be matched by above cost tariffs for other groups, an invitation to "cherry pick" for new market entrants. Possible solutions are tariff rebalancing, embedding these cross-subsidies in non-bypassable access charges, or direct subsidies.

Other policy goals

Some insights were also gathered on two other key policy goals for the electricity sector (Box 4.1).

Regulatory reform in the professions

Three reviews covered this.[5] Historically, the professions[6] have been relatively strictly regulated to ensure that practitioners meet minimum quality standards, based on appropriate qualifications. A "market failure" arising from the inability of consumers to assess the quality of services offered,[7] linked to the fact that the consequences of using inexperienced or incompetent practitioners may be severe, underlies regulation in these

sectors. The effect of this regulation is to raise barriers to entry, which limits competition. The challenge therefore is to design a regulatory system which ensures that over time, those who meet appropriate standards may enter these markets. A useful approach may be to tailor entry standards to the level of risk: where risks are low because of well informed consumers or the effects of incompetence are minor, entry standards need not be as high as elsewhere. A common practice is to delegate responsibility for setting entry standards to the members of the professions themselves, which can raise issues. A profession may also be able to limit competition through restrictions on advertising or through fee scales which remove price competition, thereby affecting the extent to which consumers can make useful comparisons.

A number of useful principles emerge from the reviews and other OECD work. Exclusive rights should not be granted where other mechanisms exist that can address the market failure with less impact on competition. Entrance requirements should not be disproportionate to what is required to perform a competent service. Regulation should focus on the need to protect small consumers. Restrictions on competition between members of a profession should be eliminated. Professional associations should not be granted exclusive rights to make decisions about entrance requirements; this needs independent scrutiny. Competition between professional associations should be encouraged, provided relevant standards are in place.

The postal sector

Two reviews[8] covered this sector, which drew out some interesting lessons, especially as regards the interaction between public service obligations and barriers to entry.[9] Entry into this sector is severely restricted in all but a few OECD countries, and there is generally a legal monopoly of certain postal services. A public service obligation, supported by subsidy, is the usual justification: the need to provide postal services to remote and rural areas that are deemed uneconomic for a competitive service. This, however, should not prevent the application of good regulatory and competition principles and practices. Is the restriction on competition necessary to achieve the objective (that is, would the public services, implicitly branded as non-commercial, still be provided in a competitive environment and without subsidy?) Liberalisation, as the countries that have done it[10] show, holds some positive surprises. Does the benefit from the public service objective exceed the harm from the restriction on competition? Does the benefit for some consumers outweigh the cost to others? Is the restriction on competition the smallest necessary consistent with achieving the other objectives? Can the other objectives be achieved in a way which reduces or eliminates the restriction on competition (that is, can the public service be funded in some other way?).

Road and rail services

Road or rail services were addressed in four reviews.[11] Broadly speaking across the OECD, domestic road freight services have been largely liberalised, while international road freight services are often still subject to relatively restrictive quotas and licensing conditions, which suffer from a lack of transparency. The pursuit of efficiency in the rail sector through reform has run into difficulties because of continuing widespread public ownership, substantial rail subsidies, and ill-defined public service obligations. Reform of price regulation emerges as important, to reflect more closely the demand for each service. As with electricity, the issue of sustaining investment is important, and needs careful

Box 4.2. **Taking the 1997 Principles forward: the sectoral perspective**

The use of competition analysis tools (Principle 5)

The effective development of competition in the potentially competitive segments of public utilities is a key element of their reform. It requires both structural change and the development of coherent new regulatory frameworks. An integral part of this process of change should be the application of the standard tools of competition analysis. A correct definition of electricity markets (covering the product, geographic and time dimensions) is an essential basis for the establishment of a regulatory framework which can handle the market power problems to which the electricity sector is prone. Competition tools can not only define the relevant markets, but can also assess the level of competition, barriers to entry, the demand side, and industry cost structures. There is scope for a more systematic deployment of competition tools in regulatory policy decision making. This implies a stronger involvement by competition authorities in the process.

Barriers to entry (Principles 3, 5)

The competition consequences of barriers to entry, especially in professional services and road freight and ferry transport systems, are large. Where the barriers are erected to protect non-commercial services, an important principle should be for these to be provided in a way that is compatible with competition. Entry barriers should only be as high as necessary to meet the public policy objective. Those based on cross-subsidies should be replaced with explicit funding arrangements. The authority responsible for setting the barriers to entry should be independent of the firms in the market. A review of barriers to entry seems a high priority, to ensure that the benefits of regulatory restrictions outweigh the harm to competition.

Non-commercial services (Principle 5)

Non-commercial services can be made compatible with competition. This means ensuring that their funding is no larger than necessary, that firms in the "profitable" markets make a contribution on a non-discriminatory basis, and that the contributions be set by an authority independent of the firms in the market. Consideration should be given to rebalancing prices so that revenues for each service at least cover its incremental costs. Arrangements have to be adapted to specific market conditions. Generally a competitive tendering for provision of the subsidised services will be the most efficient option.[1]

Competitive neutrality and stranded costs (Principle 3)

Historic incumbents may be subject to a number of competitive advantages or disadvantages relative to new entrants, so the "playing field must be levelled", if competition is to develop. Neutrality should ensure that, as far as possible, firms competing in the industry are not subject to firm-specific benefits or costs that would either hinder or enhance their ability to compete. Where the government or government-owned firms are purchasers of goods and services, transparent and effective procurement processes should be used to ensure non-discrimination.

Effective price controls (Principle 5)

Economic efficiency (and often the scope for competition) depends in large part on the efficiency of the mechanism for regulating the prices of non-competitive segments of the industry. It is important that the regulator be independent from the government and the regulated industry, and operate transparently to enhance predictability and

Box 4.2. **Taking the 1997 Principles forward: the sectoral perspective** *(cont.)*

accountability. Price controls should also ensure that incentives are maintained for investment. Where price controls are needed to prevent abuse of market power, they should be set to meet both short and long term requirements, promote efficient investment and location decisions, efficiently ration any scarce capacity, promote efficient levels of service quality, and use information on the regulated firm efficiently.

Access to essential facilities and vertical separation (Principle 5)

Non-discriminatory, timely access to essential facilities is fundamental for the development of competition. Vertical separation eliminates the incentive of an incumbent to discriminate in its provision of access. The 2001 OECD Recommendation on Structural Separation recommends that OECD countries should "carefully balance" the pros and cons of structural separation. Concerns have been expressed about lesser forms of separation such as accounting or corporate separation, because the basic incentive to discriminate still exists. Where regulatory controls are required, the regulator should be independent of government and the regulated firm, act transparently to set efficient terms of access, and take timely action to support non-discriminatory access.

Horizontal separation (Principle 3)

A competitive market structure for electricity needs to be established, ideally, at the outset, as opportunities for significant divestiture are rare. This requires an adequate number of generators in different locations which can generate electricity at different times of the day. Opportunities for disaggregation should be exploited while they last.

Demand side reform (Principles 1, 3, 5)

A key lesson of electricity reform is not to neglect the demand side of the market. Consumers who can choose their supplier will generate more effective pressure for efficiency than regulated utilities alone. Consumer choice, and associated measures such as rules to facilitate switching supplier, are needed. Experience also shows that demand can be highly inelastic, and that consumers cannot help mitigate attempts to use market power, unless steps are taken to promote greater consumer responsiveness to the cost of supply. Consumers should be adequately represented in the regulatory process.

Interaction with other policy objectives (Principle 7)

Competition is not the only objective pursued by policy makers. A sector's overall structural framework needs careful assessment so that liberalisation is matched with appropriate regulation to ensure that other policy goals continue to be met. Notably, if competition requires the interaction of capacity-constrained upstream facilities that are owned by competing downstream suppliers, the latter may have little incentive to invest in the upstream capacity, and may even discourage investment, with potentially negative impacts on reliability, safety, quality, etc. Regulatory controls to meet these other goals should, as far as possible, be implemented in a manner which is efficient and consistent with a competitive market environment. Examples of competition-friendly approaches include trading regulatory obligations[2] to minimise the overall cost of compliance, and performance-based regulations that specify the objective to be met rather than the specific means of doing so.

1. For example, Norway auctions the right to operate subsidised regional air services for periods of three years.
2. Emissions trading for example.

regulatory attention, including adequate standards and effective incentives, when the track is separated from train operations.

Ferry services

The review of Greece considered this sector. Regulation is currently heavy and often inappropriate,[12] does not take account of competition principles such as the discouragement of price collusion and oligopolistic behaviour, and barriers to market entry are significant. Access to essential facilities – in this case ports – is, again, an issue that would need attention if competition were to be encouraged.

Taking the 1997 Principles forward: the sectoral review perspective

The sectoral reviews confirm the basic Principles but also imply the desirability of some important additions (Box 4.2) as well as a few adjustments to help develop competition.

Notes

1. Electricity is a difficult market because of its physical characteristics. It cannot be stored economically in large quantities, it is subject to a wide variety of demand conditions, and the amount of power supplied to the grid must equal the amount taken out at all times to maintain electrical equilibrium and avoid physical damage to the grid.
2. Expansions help generators and gas producers in exporting regions, and consumers in the importing region, and *vice versa*.
3. Is it more efficient, in terms of the location of main electricity demand centres, to transport gas to generators, or to convert the gas to electricity for transportation?
4. Since transmission networks must be sized for peak demand, the greater the demand volatility the lower the "load factor" (the ratio of average load to peak load) and the higher the average costs.
5. Ireland (pharmacists, legal services), UK (pharmacists, legal services, architects), Germany (pharmacists).
6. Lawyers, doctors, accountants, pharmacists, etc.
7. The use of professional services such as legal services is infrequent. A lack of information may make it hard to judge quality.
8. Poland and Finland.
9. The importance of structural separation of competitive from non-competitive parts of the business, and the need to identify essential facilities (in this case letter boxes) are other issues, which echo the electricity and gas analyses.
10. New Zealand, Australia and Sweden. Finland is unusual in that it has full market opening but has not fully revised its regulatory framework to support new market entry.
11. Czech Republic, Greece, Italy and Turkey.
12. For example, rules that prevent companies from adjusting their service levels to seasonal changes in demand.

Chapter 5

Regulatory Quality

The 1997 Principles and the 1995 checklist for regulatory decision-making

Effective regulatory policies and processes are central to the 1997 Principles. A high quality regulatory environment which will contribute to better implementation of competition and market openness objectives, with wider benefits on economic performance, requires attention to the governance aspects of managing change within the public sector as well as at the interface between government and the market.

The 1997 Principles were preceded by the 1995 Recommendation on Improving the Quality of Government Regulation and its checklist (Box 5.1).

The regulatory quality reviews have used the checklist to guide an appraisal of current regulatory management systems and their evolution. The three main pillars of an effective regulatory management system to ensure high quality regulation are regulatory policy, regulatory institutions, and regulatory tools. High quality regulation[1] defines a regulatory framework in which regulations and regulatory regimes are efficient in terms of cost, effective in terms of having a clear regulatory and policy purpose, transparent and accountable.

Box 5.1. **The OECD reference checklist for regulatory decision-making**

The checklist reflects principles of good decision-making that are used in OECD countries to improve the effectiveness and efficiency of government regulation. It is not stand-alone: the 1995 Recommendation underlines that it needs to be applied within a broader regulatory management system that includes elements such as information collection and analysis, consultation processes, and systematic evaluation of existing regulations.

The checklist consists of ten questions:

- Is the problem correctly identified?
- Is government action justified?
- Is regulation the best form of government action?
- Is there a legal basis for regulation?
- What is the appropriate level (or levels) of government for this action?
- Do the benefits of regulation justify the costs?
- Is the distribution of effects across society transparent?
- Is the regulation clear, consistent, comprehensible, and accessible to users?
- Have all interested parties had the opportunity to present their views?
- How will compliance be achieved?

Source: OECD (1995), *Recommendation of the OECD Council Improving the Quality of Government Regulation.*

Regulatory policy

Regulatory policy may be defined broadly as an explicit, dynamic, continuous and consistent "whole of government" policy to pursue high quality regulation. It needs to be supported at the highest political level. The country reviews overall demonstrate that regulatory policy still needs recognition as a field in its own right. The scope and quality of regulatory policies across the OECD remains uneven. Though some countries have made considerable progress, many countries still only have fragmented elements of a regulatory policy in place, some dating back many years. To be effective and influential, regulatory policies need to link up a range of issues and processes. They should incorporate explicit goals or targets with regular reporting requirements. Key principles should be articulated, notably the broad scope of regulatory quality to support social welfare and public policy goals, not just sectional interests (when confined to the latter, regulatory policy is vulnerable to capture). Resources must be allocated to promote regulatory policy, for example to central oversight bodies, which need adequate authority for their tasks such as the formal oversight of RIA. Measures must be built in to ensure compliance with regulatory quality processes and tools, including sanctions.

Implanting an effective regulatory policy is complicated by the fact that it is a horizontal policy which cuts across other policies, and often comes up against a traditional "stovepipe" institutional architecture for policy making (that is, one in which horizontal connections between different ministries are relatively undeveloped). It can therefore often generate incomprehension, if not resistance. Competition from other, more established, easily identifiable and understandable policies (fiscal or environmental policy for example) can blur its importance.

Most important in relation to long term impacts, regulatory policies are usually some way from integrating fully the concepts of dynamism and continuity. In order for this to happen they need to incorporate two dimensions: managing the flow of rules (appraising new rules) but also, crucially, regularly appraising the stock of rules (ensuring that rules remain relevant). The need for regular review and renewal of regulation is a fundamental lesson that remains largely unlearnt to date, at least at the practical level.

Regulatory institutions

Regulatory policy needs to find its place in a country's institutional architecture. The country reviews reveal that overall, the institutional context for implanting regulatory quality is complex, and remains fragmented, with particular areas of difficulty such as the relationship between trade policy and domestic regulatory institutions. Approaches need to be tailored to different country contexts. Institutional and legal systems across OECD countries range from systems adapted to small societies with closely knit governments that rely on trust and informality, to large federal systems that must find ways of dealing with high levels of autonomy and diversity.

A wide range of institutions with regulatory functions or influence needs to be harnessed to the regulatory quality agenda. Many are long established, some are new, and some have a new or evolving role. Some are very helpful to regulatory quality, others less so. Fragmentation, both in terms of policy purpose and effective coordination arrangements, is often a problem. Can all relevant institutions be encouraged to support the regulatory quality agenda? What role should each have, taking into account accountability, feasibility, and balance across government?

Four areas have emerged in the reviews as relevant to progress: central oversight bodies for regulatory quality, the broader central institutional context, independent regulators, and subcentral government.

Central oversight bodies for promoting regulatory quality: important work-in-progress

The relationship between an effective, comprehensive regulatory policy and the existence of a central oversight body appears to be strong. They are mutually supportive, and where one exists, the other is usually also present. Central bodies going beyond improved coordination between existing bodies are therefore probably essential in some shape or form. These bodies help to ensure that regulatory quality principles are successfully applied. They can perform a number of different functions to that end: an advocacy role, a challenge function (the critical assessment of RIA), and practical and technical support for the application of regulatory tools. The market openness analysis highlights the fact that quality control of regulations needs improvement, through enhanced challenge and oversight functions. At the same time a careful balance needs to be struck: too much concentration of responsibility, authority and expertise in one place may undermine interest, commitment and responsibility in the different parts of government that occupy the regulatory "frontline".

Different approaches have been taken across OECD countries in recent years, which makes this an interesting arena of innovation in governance. Many countries have developed new specialist bodies, both inside and outside the administration. Experience suggests that central units are best placed in (or report to) the centre of government, preferably close to traditional management functions such as budgeting, rather than in a line ministry which is likely to be too closely linked to specific policy and regulatory functions. Outsiders to government and ministers are powerful levers for increasing effectiveness, especially as regards advocacy. Advisory bodies have been created in some countries which are external to the administration and hence to vested interests. But these developments are far from universal. Even where new structures are set up, they usually have to fight their way in to existing structures and interests, and often lack adequate resources and authority. They occupy an uncertain place, somewhere in the executive, cutting across many different vested interests within the executive and elsewhere, as well as traditional conventions of ministerial and departmental autonomy and the direct political accountability of ministers. So they are necessarily controversial, and may face some hostility from established interests. Also their relevance and importance is often not clear to other players because of the lack of understanding of the nature and breadth of the regulatory quality agenda.

Some countries are finding the concept of new central bodies for regulatory quality promotion hard to accept, linked to a resistance of comprehensive regulatory policy, sometimes based on the assertion that the guiding function is already embedded in existing policies and structures. In large countries such units may be easily perceived as undermining or rivalling other more established centres, as well as raising a possible threat to the potential for ministerial discretion. In small countries, with small homogeneous societies, and close and informal networks of contacts within government and society based on mutual trust, central bodies may be seen as unnecessary.

Central government institutions: working with different perspectives and contributions

The institutional architecture of central government raises key issues for the coordinated promotion of regulatory quality. With or without central bodies, the different parts of central government (the executive, the legislature, and the judiciary) each have a key role to play in supporting the regulatory quality process. This has emerged very clearly from the country reviews.

Strong central government institutions and traditions, making up the executive branch of government, exist in all countries. This includes all individual ministries, but in particular ministries such as Finance, Justice, Trade and Industry, which will continue to retain central responsibilities closely linked to the regulatory quality agenda. The executive is also a key source of regulation, both in terms of proposing new laws to parliament, and setting secondary rules to give effect to primary legislation. Other longstanding actors with an important role in regulation[2] may also need to be taken into account. The involvement of all these institutions is needed to ensure that balanced decisions can be reached on interacting policies.

The market openness reviews highlight the issue of improving relationships and communication between trade policy officials and institutions, and the parts of government responsible for domestic regulation, linked to the need to develop a more trade-friendly regulatory culture. The domestic perspective usually lacks an appreciation of how domestic regulation affects international market openness. Current regulatory culture, it is noted, often stops short of doing more than ensure respect for international obligations. Improved cooperation between the relevant officials is part of the list of issues that need taking forward on the market openness agenda.

Parliaments, which have a formal responsibility to vet and agree primary legislation, need to be more closely integrated into regulatory quality systems and processes. Some countries have built up specialised committees for specific issues, such as EU legislation. Aligning the approach taken to scrutinising legislation with the regulatory quality approaches adopted in the executive is promising, as they should be mutually reinforcing. Parliaments can sometimes lead on regulatory quality issues,[3] and appear generally to be taking a more active interest in regulatory quality and supporting tools such as RIA. The training needs of newly elected officials may need to be reviewed and strengthened.

The judiciary are also an essential part of the regulatory process because of their key role in enforcing the rule of law, and in supporting administrative accountability through the judicial review process. Judicial review can help promote regulatory quality, where there are legal inconsistencies for example, and may also help to resolve conflicts. Timescales for the judiciary's decisions, and the relative ease or difficulty with which rules can be challenged, are important factors which need to be taken into account in regulatory processes. Careful adjustments may need to be considered where the usual structures for processing issues raise difficulties on a regular basis, for example adapted court structures for dealing with the specific issues raised by liberalising infrastructure sectors.

Two other central institutions should be highlighted. National audit offices have emerged in many countries as valuable allies for the promotion of regulatory quality, progressively widening their role. They now often play an important role, beyond accounting for the efficient use of resources, in assessing the performance of the administration, including the effectiveness of implementing regulatory regimes. They

focus on whole areas of policy and on outcomes, so they help to fill the gap of current regulatory quality approaches which often fall short on this. They have an advantage too in being independent from government (usually reporting to parliaments), transparent in their work and with a remit to operate in a wide range of areas. Secondly, national ombudsmen play an important role in reinforcing democracy, by promoting administrative accountability.

Independent regulators: helping to promote transparency and market competition

The rise of independent regulators is a relatively new development for many countries.[4] The term covers not just economic regulators for the network industries, but also other types of regulators such as those set up to support civil liberties and foster administrative transparency. Their main functions vary significantly across countries and between regulators in the same country. But very broadly speaking, they tend to be concerned with rule enforcement and the application of sanctions for non-compliance with rules relating to their areas of competence, and authorisations for the issue of licences and permits.

Independent regulators have proved to be an important step forward for better regulation of sectors and issues, for a number of reasons. They help to prevent political interference and the influence of special interests. They contribute to the improvement of regulatory quality, transparency, stability and expertise. Not least, they are a necessary institutional development for marking out the separation of the State's roles as policy maker/owner and regulator, a role which is especially important in countries that have chosen to maintain a significant number of State-owned enterprises. They can also be powerful advocates for further and more effective reform.

But they raise issues too which will need further attention. Their independence from ministers can be weak. They need adequate resources and competences to carry out their role and to enjoy an appropriate level of independence. But independence in turn raises the issue of accountability, perhaps the biggest challenge for their future development. The difference between policy making and regulation is not always clear. Regulators are primarily rule enforcers, but the line is often blurred between rule-making and rule enforcement. Regulators are increasingly a source of technical expertise and are often consulted in the policy-making process and the preparation of primary legislation. They are often responsible for the interpretation of primary rules. Some regulators also make the secondary rules to back up more general primary legislation, which means a lot of interpretation.

Independence therefore needs to be balanced with clear accountability mechanisms, which is work-in-progress in virtually all OECD countries. This is especially important in relation to parliaments: democratic legitimacy needs be reinforced given that independent regulators are non-elected. The accountability "feedback loop" also needs to involve dialogue with policy makers, and directly with citizens (for example through clear information on websites). Evaluation mechanisms for their performance and governance structures need attention too, balancing flexibility with the need for independence and credibility. Appeal systems against independent regulators are needed, but again the right balance must be found to avoid the risk of undercutting their independence and effectiveness. Independent regulators should not be confronted with high level political/policy choices which are for other government institutions to resolve.

Other issues raised by independent regulators include capture, which can be of different kinds: political capture, capture by the entities they regulate, and commitment to a specific sector which may slow rather than encourage structural change in converging sectors. Independent regulators often escape the obligation (imposed on others) of having to apply regulatory quality standards. Where regulators make rules or interpret them, they should be under the same disciplines as for other rule-makers notably as regards RIA and consultation. Sanctions and enforcement powers are essential for their effectiveness but sometimes not strong enough.

There is a fairly rapid development of best practice and answers to these issues. The establishment of a general framework for the evolution of independent regulators may also be useful, to counter *ad hoc* developments with no guiding principles.

The relationship of sector regulators with competition authorities is especially important and was picked up in the competition reviews (Box 5.2). Overlap giving rise to lack of clarity over responsibility for competition issues can be a problem and competition policy may become fragmented. Cooperation agreements are important and can extend even further, such as joint projects to review difficult issues or sectors.

The sectoral reviews also include regulatory institutions on their list of key issues for the effective development of competition in the network sectors. The reviews report some concerns about the independence of regulatory authorities from the government and from the regulated firm, transparency, speed of decision-making, staffing, resources and the relationship to the competition authority (which the competition reviews also picked up; see Box 5.2).

The sectoral reviews highlight the special importance of independent regulators in boosting market confidence that the entry of private capital will not be vulnerable to uncertain, politically-driven future government decisions. The need to separate government's ownership role from its regulatory role is underlined. Independent regulators are also important for ensuring non-discriminatory access to essential facilities. *Ex ante* rather than *ex post* regulation for this is stressed in the reviews. The rapid resolution of key issues is important for new market entrants. For this reason, the scope of appeals from regulators' decisions was found to be worrisome in some countries, as it may be used by incumbents to delay important decisions for their competitors. The reviews lend strong support to the need for independence to be balanced with accountability mechanisms. But they also note a number of other virtues of an effective independent regulator, notably transparency, predictability and efficiency. Transparency is underlined as a key factor, including the engagement of consumers and the wider public. Adequate regulatory resourcing was found to be an issue in a few countries.

More specific to electricity is the issue of independent system operators (a form of regulator) for ensuring non-discriminatory generation dispatch and system management, a difficult area where approaches are work-in-progress.

Subcentral governments: increasingly important but a very imperfect link with the regulatory quality agenda

The importance of subcentral governments has emerged clearly in the reviews. Local governments are of increasing importance in unitary States, including historically strong ones. There is an increasing awareness of the importance of the federal/state interaction in federal States. These are positive general developments as they help to release local

Box 5.2. **Sectoral regulators and competition authorities**

Infrastructure is the most common setting for special competition policy regimes and sectoral regulators. Competition law was irrelevant to State owned monopoly utilities until competition began to appear for some of their services or functions. This has been an area of significant change since 1997, marked especially by the emergence of sectoral regulators and regulation. Regulation, often by a sectoral regulator set up for the purpose, is commonly now in place to control the natural monopoly cores of these sectors, where these exist and have been disaggregated from other, potentially competitive, activities. Regulation also often extends to controls on prices and entry. Special regimes are harder to justify for transport infrastructure sectors that do not have a natural monopoly core.

The relationship, formal and informal, between the competition authorities and sectoral regulators is central in determining how competition principles are applied. Their approach to the same issues may diverge, with the added complication that there may be more than one relevant law. The review of Italy for example noted that it is possible for the competition authority and regulators to deal with the same conduct, applying rules drawn from different sources, and that there is scope to make different judgments about issues such as pricing of access to networks.* Where relationships are not clear, the reviews have recommended improvement. But formal coordination processes are less important than a shared policy view in ensuring consistency and agreement over what to do.

The country reviews have revealed some broadly consistent institutional and legal patterns and reform paths. Competition law has been an important tool in the reform and restructuring of infrastructure monopolies, often leading the way. Regulators are commonly responsible for prices and services. They tend to have a shared jurisdiction with competition authorities over disputes about network access, the latter applying general rules about abuses by dominant firms.

Beyond this, the picture varies. Competition authorities may have a controlling role over regulatory intervention. Notably, where regulatory intervention is triggered by market power in the regulated industry, they may be responsible for defining the market and determining whether a firm has market power. In a few countries, the sector regulator applies competition laws that are custom built for that sector, but this can raise serious inconsistencies with competition principles. Sector regulators under these arrangements have on occasion approved anti-competitive mergers, for example. "One law-many regulators" appears to be a better approach, encouraging convergence and reducing conflict. Another model is to combine all the institutions which apply laws affecting competition, including the economic regulation of infrastructure sectors, into one. Competition authorities have sometimes been given this role, but it is important to distinguish between authorities that apply *ex post* enforcement of competition law, and those that also cover *ex ante* sector regulation.

Oversight from the courts can encourage consistency and correct conflicts. Some countries have set up specialist tribunals to deal with competition issues linked to sectoral regulation, including judges with commercial law experience.

* The judgments may be hard to make in any case. Determining whether network access pricing is appropriate even in the relatively straightforward context of competition principles of abuse of dominance is hard, because the true economic costs are difficult to establish.

initiative in the management of the economy and society, and bring government closer to the citizen. Regulatory quality needs to be cascaded systematically through the different levels of government. Failure to carry out effective regulation at one level of government can undermine efforts elsewhere.

In a few countries local governments have been active agents for improving regulatory quality, sometimes even the drivers.[5] But other countries still have some way to go in improving their regulatory framework at the local level.

Concerns about rule-making quality at the local government level are picked up in the market openness reviews, which note that public procurement, often carried out at local level, can raise issues for foreigners and others too, if processes are not transparent. The creation of new local rules is often not subject to central disciplines such as RIA. There is often a lack of resources and training to promote more effective rule-making. Compliance and enforcement is another issue. Who monitors compliance and enforcement of national rules at the local level? The number of local entities and the number of layers has been picked up as an issue in some countries. Are there too many local entities for efficiency? Is there an issue of duplication and overlap? Some overlap is unavoidable. Effective coordination/cooperative arrangements need to be in place. But the reviews suggest that there also a need to avoid too many arrangements, or too few.

What should be devolved? The fifth criterion on the 1995 checklist (see Box 5.1) already offers some important insights into the issues. The importance of deploying appropriate levels of government for policy areas and articulating their role will differ according to the policy area. This is important both for the efficiency of the economy, and the effectiveness of government action. For example the OECD PISA study suggests that successful education systems are those which combine standardised central targets for educational outcomes, with decentralised flexibility and responsibility for how to achieve them such as teacher recruitment and school management.

At a more strategic level it is important to achieve the right balance between central authority and local autonomy. Decentralisation in unitary states inevitably saps some of the driving force behind action by central governments as the levers of power must be shared. A strong and strategic direction for regulatory quality must be retained at the centre. At the same time, useful innovations are at least as likely to emerge in cities and regions.

Another key issue is fiscal relationships. Local governments need adequate resources for their tasks. Responsibilities must be matched with necessary budget allocations especially where new or broader mandates have been given. But it is also important to get the incentives right for wise spending. Tax and spending relationships between central and local governments need to promote incentives for cost control, and encourage the use of cost-benefit analysis. Effective regulatory frameworks to which regulatory quality principles are applied can help to address these issues.[6]

Regulatory tools

There are six key areas: administrative simplification, RIA, transparency and communication, alternatives to regulation, compliance and enforcement, and tools to support administrative justice and accountability which are important for the effective implementation of rules.

Regulatory tools are on the whole more developed (at least in principle) than policies and institutional architecture, but there are gaps and weaknesses. Further research on applying

cost-benefit analysis (CBA), on self assessment, on alternatives to regulation, and not least on evaluating the performance of regulatory tools (among other areas) would be useful.

Though tools such as RIA offer a much broader and deeper scope for improving regulatory quality, many countries still focus much of their effort on administrative simplification. Overall, not enough use is made yet of the potential for deploying other tools.

Administrative simplification

Administrative simplification probably remains the most commonly used regulatory tool. Few regulatory reforms are more popular than promises to simplify government "red tape", and one of the most common complaints from businesses and citizens in OECD countries is the number and complexity of government formalities and paperwork. Administrative simplification has been highlighted as an important contribution to product market competition, which in turn feeds into enhanced economic performance. Reducing administrative burdens helps businesses, especially SMEs. Burdensome administrative regulation raises company costs, impedes market entry and innovation, and hurts competitiveness. Reducing administrative burdens, permits and licences can also help create a political constituency for reform, especially among SMEs, that can support subsequent deeper regulatory reform.

Administrative simplification is an important ally of efforts to reduce the scope for unnecessary trade restrictiveness, in customs procedures and more generally (Box 5.3).

Efforts at administrative simplification have been going on for many years. There has been growing awareness and steady progress with tools, especially use of the Internet (government websites, gateways to further information, online form filling), one stop shops, central registries of formalities, the redesign of formalities such as permits to reduce complexity, review and streamlining of existing laws, and sunsetting processes for new laws. Some countries have made a focused commitment to reducing burdens on SMEs, with success in terms of an improved environment for the development of SMEs in which regulation for starting up a business is kept to the strict minimum.

But overall success is mixed. Burdens appear still to be rising, at the same time as government action is taken to try and deal with the problem. Most countries still face the challenge of identifying and managing administrative burdens imposed by new or existing legislation. This is sometimes poorly understood, as governments do not know the burdens on their businesses and cannot make informed policy choices to improve matters. Regulatory complexity is an issue in many countries, fed by a growing number of laws which then need interpretation.

The roots of the problem need attention, and are often too easily overlooked. For example, re-designing permits sidesteps the question of whether permits are necessary in the first place. Regulatory quality principles applied *ex ante* to new rules and laws, before they are adopted, would improve clarity and simplicity, reducing the administrative formalities needed subsequently. Ex *post* simplification and codification is not enough, and may mask the real problem of poorly designed or even unnecessary rules.

RIA and effective ex ante *evaluation*

Regulatory Impact Analysis (RIA) is perhaps the most important regulatory tool available to governments, as its aim is to ensure the most efficient and effective regulatory options are chosen. Most of the 1995 OECD checklist relates to RIA good practice. It remains

Box 5.3. **Administrative simplification, trade facilitation and market openness**

Decisive action by governments to reduce administrative burdens on business can be extremely helpful to trade and investment. Important areas of action include promotion of public services (including through the Internet and one-stop shops) improved dialogue between government and businesses, and customs procedures.

The market openness reviews underline the growing trend for e-government and electronic service delivery, which benefits both foreign and domestic firms. One-stop shops increasingly make skilful use of the Internet. Online facilities may for example group together administrative requirements such as permits, allow one transaction to cover all the required start-up procedures, and bring together business related information. But such arrangements are not yet common practice.

Simplified, automated customs procedures offer another important avenue for minimising trade restrictiveness. Endeavours to streamline in border operations have emerged as a key indicator of capacity and commitment to market openness, through simplification of customs documentation, avoidance of duplicative requirements, reduction of unnecessary controls and enhanced transparency and accountability. Some countries have gone a long way, with efficient customs information services pre-arrival customs processing, better targeting of high risk goods and fewer physical controls of other goods resulting in a faster movement of trade flows. Although not essential for customs simplification, automation has been a valuable efficiency-enhancing tool allowing firms and customs to communicate electronically for all documentation and authorisation actions.

But impressive progress by some countries masks important challenges. Persistent shortcomings include non-interoperability or geographic exclusivity of certain computer systems which compromise the value of EDI, and the lack of interface with licensing authorities. More broadly, the weakness of multilateral trade rules to guide development of transparent and predictable customs procedures contributes to uneven implementation of rules at different border crossings and discretionary abuses by customs officials in some countries.

a highly valid reference. But RIA is a challenging process that needs to be built up over time, an issue that is confirmed by the most recent country evidence. Existing RIA guidelines are not always applied, or are applied ineffectively or inconsistently, despite the fact that the use of RIA has become widespread if not universal, with initial efforts dating back to the 1970s and 1980s in some countries. There is a wide variation between countries too in terms of how far RIA is now embedded in the regulatory process. It is firmly entrenched in some countries (which does not necessarily mean it is well applied), but others are still at a much earlier stage.

Key issues with RIA are set out in Box 5.4.

Beyond these general issues, the competition and market openness country reviews demonstrate very clearly that competition policy and trade perspectives are usually not strong components of RIA, with very negative repercussions on the integration of trade and competition policy and principles into regulatory decision-making.

Box 5.4. **Key issues with RIA that need attention**

- *Omissions.* RIA is not applied yet to all rules, and to all rule makers. The use of RIA remains partial, with large parts of the regulatory structure in most countries not subject to its disciplines at all (such as local governments, especially in federal States, or independent regulators). Quasi regulation is an issue.[1]
- *Whole regulatory regimes.* RIA is relevant not just for individual rules but also for whole regulatory regimes (such as for the network industries). Assessing individual rules out of context may undermine the potential of RIA to aid better rule-making.
- *Evaluation.* How well is the regulation likely to achieve its objective? There are important weaknesses in the use of quantification methods, CBA techniques and evidence-based justifications to support evaluation which need further deployment and development.
- *Compliance with RIA (and other regulatory quality mechanisms) in the administration.* This is often poor, with a lack of sanctions, and a lack of resources for enforcement. Poorly prepared regulations which do not conform to process rules may remain unchallenged.
- *Complexity and fragmentation.* Too many checklists exist in some countries, which can cover a range of issues (such as social and economic impacts, gender, regions, and business environment).
- *Targeting.* To avoid overload, RIA needs to be targeted at regulations with the largest potential impacts and the best prospects for changing outcomes.[2]
- *Integration with consultation.* RIA is often separate from/not included in consultation processes, reducing the scope for generating the data needed to maximise RIA's effect on decision-making, and undermining its acceptance by stakeholders – and so slowing the cultural changes needed to ensure that it becomes a key part of the decision-making process.

1. Efforts to reduce regulatory complexity are often offset by the development of grey rules, often outside the disciplines of RIA and other regulatory quality tools. Such rules have an uncertain legal status of such rules. Though soft law is often meant as guidance for simplified laws, non compliance with the guidance may be taken as an offence. So it acquires the status of law, without going through the processes for "real" laws.
2. Korea and US offer examples of how to do this, by defining "significant reform" for priority treatment (based for example on costs, or the number of people affected).

Competition authorities often participate in "one-off" reform or review programmes. It is less common for them to be actively involved in ongoing processes of regulatory review and evaluation, such as RIA. The regulatory quality reviews show that some consideration of effects on competition is common where RIA standards are formalised. But although the reviews did not address the issue systematically, it is fair to conclude that a clear principle of "least anti-competitive means" is not yet prevalent. This is a stringent test though, which may need to be balanced against assessments of least impact on other values such as personal privacy.

Including competition in RIA is the essence of the regulatory process recommendations. But how? Should a specific RIA checklist[7] be recommended? This would not involve having the competition policy office or enforcement agency review and clear every proposal. Rather, a well-designed RIA process should include criteria to identify rules that might have significant competitive effects, for referral to the competition policy experts who would then do a more thorough assessment. The process should be explicit about the role and power of the competition authorities. If the assessment concludes that

the proposal would indeed constrain competition significantly, the proponent of the proposal should be required to respond to that finding, either to correct the proposal to eliminate those effects or to explain, publicly, why it is required in the public interest.

RIA is an important potential support for market openness, which stands to gain considerably from further improvements in its effective implementation. Indeed many reviewed countries rely on RIA to avoid unnecessary trade restrictiveness, as the RIA process provides a systematic approach to assessing the impacts of a proposed regulation. But RIA processes could be generally improved, and the link with trade and investment rules is often tenuous. Although a few countries include an explicit requirement to assess trade impacts, many others have no such requirement, so the link is weak and implied rather than explicit. For example potential impacts on market openness are unlikely to be examined unless the proposed regulations relate directly to trade and investment. RIA is therefore not often directly or consistently applied in terms of considering the impact of rules on trade and investment. Effective consultation procedures for new rules can help to mitigate the lack of formal integration of trade perspectives in RIA (assuming that consultation is not too dissociated from the RIA process, see Box 5.4), by providing opportunities for foreign as well as domestic stakeholders to comment.

Transparency and consultation

Transparency is one of the central pillars of effective regulation and a fundamental determinant of market openness for both domestic and foreign participants. The ability of businesses to understand fully the regulatory environment in which they are operating, and to have a voice in regulatory decision-making, go hand-in-hand in ensuring effective quality of market access. The country reviews offer valuable insights into the mechanisms for promoting transparency.[8] They also confirm that it is a challenging task, involving standardised processes for making and changing regulations, consultations with interested parties, effective communication of the law and plain language drafting, publication and codification, controls on administrative discretion, and effective implementation and appeals processes.

Transparency is becoming harder, not easier to promote in modern societies. It can be difficult to accommodate those who may lack easy access to regulatory processes and who are not part of the "establishment", but whose views are nevertheless important in securing effective regulatory outcomes. Less organised or broad groups such as taxpayers, consumers, SMEs and foreigners may be left out or play a more marginal role than they should. Consultation fatigue appears to be a growing issue. The breadth and eclecticism of consultation mechanisms, or too much consultation, can unintentionally result in this. Local government, businesses, and citizens can easily be lost or overwhelmed. Grey regulation has also been picked up as a growing concern, and is a striking feature of some regulatory regimes.

The case of foreigners has emerged strongly in the market openness reviews (see Box 3.1). Issues related to international market openness picked up in this context are also relevant to domestic players. Effective use of the Internet emerges as an important feature which is developing rapidly, but is not yet fully mastered in many countries. Another specific transparency issue that has emerged from the market openness reviews which is equally relevant to domestic players is government procurement (see Box 3.2).

More broadly, transparency must take account of organised groups and vested interests that have built up over time in many countries. This is especially the case in consensus-driven societies with formal mechanisms for identifying and involving important stakeholders (they may end up excluding some, often unintentionally). Powerful players and interest groups in traditional consultative structures such as organised labour can block change. The social partners (employer and employee groups) may also exert a special influence on consultation.[9] There is a risk in these situations of blurring the line between obtaining advice on policy issues and undermining government's democratic responsibility to take a final view.

More open and accessible procedures are more legitimate, less vulnerable to capture, and more likely to bring high quality information that improves analysis of regulatory and policy options. Discretion in deciding who and when to consult should be minimised and transparent to avoid insider capture. Consultation approaches need to be adjusted to the country's context. But general principles have emerged and overall, despite the challenges, there are encouraging signs of evolution toward more rigorous arrangements. The "Notice and comment" procedure is proving a very effective means of maximising the engagement of relevant stakeholders. Online systems for communication and consultation are also increasingly used (although policy makers and regulators need to assess the implications of the digital divide for universal access and the design and update of websites needs care too).

Alternatives to regulation

The use of a wide range of mechanisms for meeting policy goals, not just traditional regulatory controls, helps to ensure that the most efficient and effective approaches are used. Approaches include green taxes and subsidies, voluntary agreements, information programmes such as eco labelling, self-regulation, permit trading schemes, and performance-based regulation (where a sector or industry must comply with a standard, but can broadly choose how to meet it). These developments reflect a changing relationship between the State and businesses/citizens, and support the "light touch" needs of market economies. But alternatives are often poorly developed, and are still mainly used in the environmental context.

A significant implementation gap exists between available tools and practice. The first response to a problem is often still to regulate. Governments must lead strongly to overcome built-in inertia and risk aversion, and reinforce regulatory guidance. A better understanding is needed of options to regulation. A willingness to accept policy risks is another factor, as many alternatives are relatively untested. Substantial technical and practical support is needed, with economic training in evaluating options. Some alternatives such as emission trading can be complex to implement. Other regulatory tools such as RIA may need adjustment to ensure that alternatives can be "drawn out". Implementing systematic reviews of the impact and performance of regulatory alternatives is likely to be helpful.

The trade-specific regulatory agenda offers some helpful examples of the potential value of alternatives to classic "command and control" regulation. Streamlining conformity assessment procedures may not always require a rules-based approach, but rely instead on self-declaration of conformity, or on the regulator's discretionary judgement as to whether verification is needed case-by-case, and spot checks. These approaches highlight the scope for businesses to take the initiative, a principle which could be extended more broadly to citizens and, via constructive dialogue with regulatory

authorities, encourage business and citizens to make their own proposals as to the best way of meeting regulatory objectives. The market openness reviews emphasise that the capacity for embracing regulatory alternatives is important in helping to shape more trade-friendly regulation. The sectoral reviews also draw attention to the scope for using regulation that defines the objective rather than the specific means of attaining it in meeting efficiently the often complex mix of policy goals underlying infrastructure sectors.

A cautionary note should nevertheless be struck on self-regulation. It needs to be handled with care. It can block new market entry. The sectoral reviews suggest that the authorities responsible for barriers to market entry should be independent of the firms in the market. The transparency with which self-regulatory schemes are set up and sustained is an issue, which particularly disadvantages foreigners. There seem to be few if any controls in place across countries to hold relevant entities accountable to a high transparency standard. The country reviews have also picked up the absence of consolidated information on self-regulatory schemes, as well as internal rigidities in the way they are set up, which *de facto* can exclude foreign participation. Problems can arise, for example, with self regulatory schemes run by statutory national industrial organisations, and where the government has delegated regulatory powers to such entities.

Effective management and more vigilant oversight of self regulatory schemes is needed, including a stronger framework for determining when they are most appropriately deployed to minimise the risk of abuse and capture. How to do it properly is still work-in-progress, for example, determining the appropriate level of government oversight, ensuring transparency, and establishing controls to reinforce responsibility and accountability. Issues with self regulation are picked up in the sectoral reviews which consider the professions, noting the need to manage potential excesses of self-regulation schemes that work too much in favour of their members. Competition issues have also been picked up in the competition reviews. Self regulation raises issues if competitors in a sector use it to control competition. Self regulatory associations are the usual vehicle for this type of regulation. They may be legally restrained from anti-competitive action, but effective sanctions to deter such conduct may also be required. In a few countries there is an issue of guidance, which may be quite informal, from the ministry or regulator, supporting horizontal cooperation. Competition law intervention can be used to help reform self-regulation restraints, notably in professional and other services.

Compliance and enforcement

Compliance and enforcement are the poor relations in the regulatory toolkit. Adoption and communication of a regulation set the framework for achieving a policy objective. But effective implementation, compliance and enforcement are essential for actually achieving the objective. There is not much point having regulation with a low rate of compliance. And inadequate compliance may also be a major cause of regulatory failure. Countries, perhaps not surprisingly, find it easier to focus on the first issue-adoption and communication of a rule – than on the second – ensuring that it is respected. This is a particular problem in the transition economies, and wherever an informal economy takes hold.

Compliance is closely linked to good regulatory design in the first place, as well as effective enforcement tools. A well implemented RIA which includes ex *ante* assessment of compliance prospects is key. This is often part of countries' regulatory checklists and RIA guidelines, which stress the need to consider compliance when making regulations (and sometimes say that a regulation should not be adopted if the compliance prospects are

poor). But is this taken seriously? *Ex post* review of the effectiveness and efficiency of existing regulations is also important to spot compliance issues, together with an assessment of enforcement efforts and capacities and the development of strategic approaches, including the efficiency of the judiciary, for their improvement.

Administrative justice and accountability

The relationship between regulators and the regulated needs to be balanced. Regulators must apply and enforce regulations systematically and fairly, and regulated groups or individuals must have access to administrative and judicial review of regulators' actions that affect them. Access to review processes ensures that regulators[10] are held accountable for their actions. Accountability is a necessary corollary to transparency: making clear the processes by which regulatory powers will be deployed by the authorities, and making clear at the same time the rights and protections for businesses and citizens.

This is important not just from an individual rights perspective, but because it is central to the ability of regulation to achieve its objectives. What drives the willingness to comply of regulated groups and individuals? Part of the answer lies in effective systems of administrative justice. A number of important tools are available for this, such as administrative procedures acts, the use of independent and standardised appeals processes, and the adoption of rules to promote responsiveness, such as "silence is consent". The first of these is the most widespread, suggesting scope for further use of the other tools.

Although some countries have long had administrative justice legislation – Administrative Procedures Acts – adoption or updating of this type of legislation has recently accelerated. These Acts often have a broad scope, addressing issues of effective public management which include rules about the rule-making process (including for example RIA and consultation) as well as the rights of citizens and businesses. Another important general trend has been the more widespread adoption of independent administrative appeals processes, often resting on the key principle that complaints may be heard by an administrative body other than the one responsible for making the initial decision.

The availability of judicial review of administrative decisions can be seen as the ultimate guarantor of transparency and accountability, and is likely to improve the quality of the decisions made during administrative review. In some countries, judicial review, as well as being an important individual right, has also become an important mechanism for regulatory quality control. Scrutiny by the judiciary, for example, may capture whether rules are consistent with primary legislation, and help to assess whether rules are proportional to their objective.

Overall, formal avenues for appeal of regulatory decisions seem fairly well established, though user satisfaction varies. Administrative and judicial review processes are also generally costly and time consuming means of obtaining redress. SMEs may feel that it is not worth the effort, and instead may shift the burden of regulatory costs to consumers or reduce their level of compliance. Businesses generally may be disinclined to use the processes.

The importance of clear, open and effective appeals procedures is an issue that was picked up in the market openness reviews. In most countries, the formal legislation setting out appeal procedures shows little evidence of overt discrimination between nationals and foreigners. Some national legal systems build in explicit assurances that foreign parties may effectively access appeals procedures, for example in countries with highly proactive

investment promotion policies. But formal appeals processes are frequently viewed as cumbersome, time-consuming and inefficient. A recurrent theme is the need for clearly defined time limits for the treatment of an appeal, to avoid it dragging on for perhaps years. Even the perception of burden and slowness can seriously undermine business confidence and constrain business use of the system. Informal avenues of appeal which supplement the formal system in some countries are not in practice helpful to new market entrants, because they tend to be opaque, disparate and based on national cultural attitudes that are hard for outsiders to decipher. Seasoned "insiders" will almost inevitably do better than outsiders in using these other processes.

Promoting regulatory quality for the future: evaluation

With the development of regulatory policy, there is an increasing interest in systematically assessing regulatory policy performance. Do good regulatory policies deliver good regulation? Evaluation is needed of the performance of regulatory tools and institutions, as well as regulations themselves. It is important to justify the costs of regulation against its benefits. Interest in this issue has continued to grow and broaden.[11] Policy makers involved in regulatory policy are being held accountable for the significant economic resources as well as political capital invested in regulatory management systems.

Developing a better understanding of the link between regulatory quality processes and actual regulatory performance

This is important, and ex *post* evaluation techniques are part of the answer. At the same time, this work supports a more effective "daily" application of regulatory quality. Which tools and institutions work? What contributes to their effective design? Work is in progress to identify and assess practices and methodologies for the assessment and monitoring of regulatory tools and institutions. Some countries already have an explicit strategy for their *ex post* evaluation. Tools covered include RIA, consultation mechanisms, simplification measures, and institutions include central units and independent regulators. Evaluations have helped to strengthen tools and institutions, though important challenges have been reported by countries: methodological challenges, resource issues, some resistance from participating institutions, the need to find a home for regular audits, and data problems.

A step forward would be a broader and more systematic monitoring and evaluation of regulatory performance, one which might cover all regulations and take a consistent approach. Even more ambitious would be an assessment of regulatory performance in the broader context of "good governance", to see what difference it makes to policy performance and outcomes.

Learning from failure as well as success

Analysis of regulatory successes and failures should help to improve regulatory management systems. What went wrong... or right, and why? Was it a failure to update? A failure to comply? A failure to be clear about the primary goal (for example in relation to privatisation, revenue raising or real market opening) or of some key element(s) of the regulatory structure?

Regulation may not work if other issues have failed to be addressed, for example structural reforms of the network industries to counter the discriminatory behaviour of vertically integrated monopolies. For SMEs to flourish, administrative simplification is

important but a range of other policies need to be in place. The network industries attract considerable attention, where failures can be spectacular (electricity blackouts, rail crashes). But other policy areas deserve attention too: environmental and health and safety regulation have sometimes been rebuilt in recent years. Regulatory policy may be overshadowed by other major policy decisions and economic developments.[12] This is important because successes and failures are likely to have roots that go beyond regulation. In the case of failures, where the reputation of regulatory systems is often on the line, regulation may not deserve all the blame. A careful assessment of the contributory factors to what is often labelled as regulatory failure is needed. *Ex post* evaluation of these issues may also help in reducing the risk of failure through monitoring and learning, and in picking up successful innovations.

Promoting regulatory quality for the future: cultural change and communication

Promoting cultural change within administrations

In many countries administrations have not yet fully integrated the need for regulatory quality, and remain too inward-looking. Improving the State-citizen and business relationship is the starting point. The administration needs to be approachable, avoiding secrecy, complexity and opacity in administrative acts. Modernising the public administration involves promoting a service and client-oriented attitude from the staff of public institutions, and a less bureaucratic and administratively burdensome approach. Most countries have already recognised and acted on these aspects of administrative culture. Examples include laws on access to administrative documents and the proper justification of administrative acts, and user charters.

But this is only the start: much deeper reforms are needed to embed a cultural awareness of regulatory quality and its importance. Ministers and senior management in administrations may lack a full awareness themselves of the importance of regulatory quality, and so often do not communicate it properly. Because the "cascade" effect from top management down is often missing, the incentives to act may not be very strong further down the line. RIA should be applied at the right moment in the policy-making process (that is to say, early) and with sufficient enthusiasm and effort, by a "regulation-aware" culture. Cultural changes among regulators (defined in the broadest sense of the term) are required to support a regulatory system which systematically generates high quality regulation and which is fully integrated with the governance agenda.

Developing a stronger economic and policy perspective is another priority. The legal quality of a rule often remains the primary focus, rather than the overall ability of the rule to meet policy objectives. The latter is often seen as an "add-on" which takes time and saps resources, rather than an integral part of the process. The legal framework is an essential backdrop for well-functioning market economies. But especially strong legal cultures complicate the task of developing an economic perspective or a full appreciation of the importance of evaluation.

Linking regulatory awareness to broader governance changes for the public sector needs attention too, and particularly to public sector human resource management and budget management reforms.[13] Modern public management techniques need to permeate more deeply, especially at local level. But all institutions related to the governance and policy-making process need to be part of the cultural change. This is a sensitive issue

where progress is likely to take time. But some countries have already gone a long way, successfully. For example, output oriented budgeting emphasises the regular evaluation of programme outcomes. Regulatory evaluation has a role to play in this.

Concrete measures are needed to promote a new culture. Civil servants are, on the whole, not yet adequately trained to be effective regulators. Regulatory policy and regulatory techniques are generally a low priority in training programmes, with RIA a particular weakness. Making RIA requirements operational, especially CBA, and generally promoting better quality RIA, means equipping officials (including local government officials) with the necessary skills. The need for better training has also been highlighted by the market openness reviews, which underline the importance of training to inject a greater awareness of trade perspectives. The challenge implied by this in the broader context is large: developing, over time, capacities for identifying and helping to deal with different, sometimes conflicting, policy goals which are given expression in the regulatory framework.

Promoting better communication, engaging stakeholders

To move regulatory quality forward is an issue for all countries. The list of challenges is long. It includes vested interests, risk aversion, inertia, fatigue, opposition, lack of understanding of what regulatory quality can do, and confusion.

What regulatory policy is and what it can do are often still not clear enough to stakeholders, especially the general public. People outside the process may often focus narrowly on de-regulation and administrative simplification. Governments can identify the contribution of regulatory quality to meeting easily identified objectives with a practical relevance to society, such as simpler administration, or lower prices. This can help citizens and businesses to be more supportive. But there is a need also to find a way of effectively communicating both strategic directions and the importance of the longer term (pension reform linked to intergenerational equity for example).

Promoting a shared responsibility for necessary reforms is a starting point. Is the general public well informed, not just of proposals, but of developments and results? Does its understanding of reform lag the reality? Strategic coherence and clarity matters here. Communicating the intentions and benefits of reform – explaining the policy purpose – is one element. Monitoring and communicating reform progress and results are also helpful, to sustain momentum. For example important RIA results should be communicated. Introductory summaries to proposed rules often do not say much about costs for business and citizens. Feedback from regulated industries and citizens can also help to pinpoint what works and what does not, such as ineffective regulation to promote service quality in newly opened network industries.

There are more specific targets beyond the general public. Currently marginalised stakeholders who would benefit from reform but lack a strong voice are useful potential allies, and if necessary, procedures might be adapted for them. SMEs for example often find it hard to afford the time and money to participate in the traditional rule-making process. Winners and losers need careful management. Consumers are potential winners, but governments need to be honest about expected reform timescales and results, so as not to undermine future support for reform efforts. Results may take time. One key group of losers often emerges from the structural adjustments that may go with the introduction of competition and privatisation in monopoly sectors. They need time to adjust, and to be involved in the transition.[14] Losers from reform are often a small group made up of

individuals who bear relatively large losses (such as loss of employment with no realistic expectation of getting another job because of age), and region specific with negative multiplier effects on local economies. Gainers are the country at large, and individual gains are small and often invisible.

Building public awareness of what trade-friendly regulation can achieve for market openness is one of the issues that the market openness analysis includes in its list of future challenges.

Dealing with vested interests is a challenge. Vested interests may not necessarily be aggressive in the face of change (though they can be) but their accretion over time puts them in a position of strength. An awareness of the potential strength of inbuilt resistance is one of the first steps to effective, planned, management of regulatory change. Yet governments often do little to prepare for resistance and to promote understanding of the importance of regulatory quality. Vested as well as new interests need to be engaged, in a process which might be defined as "escorting" the transition from old to new. This applies both internally to the administration as well as externally. Persuading government officials of the need for reform and the benefits of regulatory quality and giving them a stake in change (for example allowing officials from different ministries to work up new systems together) is a start. The alternative is to wait for a crisis and then seize the opportunity to push for widespread change.

Last but not least the regulatory quality agenda needs to find a way of riding the political cycle across electoral shifts (whilst leaving room of course for political discretion) and maintaining momentum in the absence of a crisis. Administrative simplification reforms are usually non contentious, because everyone can easily see the point of them. They may help to bridge the periods when broad, cross-party political momentum for reform is lacking, but ways are needed to promote a broader and deeper support of regulatory policy which extends well beyond this issue. Approaches might include strengthening institutions and identifying stakeholders for change who are not linked to the political cycle.

Taking the 1997 Principles and the 1995 checklist forward: the regulatory policy perspective

Key elements that make up an effective regulatory quality landscape have become clearer since the mid-1990s. In principle, if not always in practice, the focus has shifted from the relatively simple goal of deregulation to the improvement of regulatory quality, including re-regulation where necessary; from the idea of one-off regulatory reform to the continuous promotion of regulatory quality; from legal quality to substantive, "fit for the policy purpose", quality. The three essential and linked pillars for the promotion of regulatory quality – regulatory policy, regulatory institutions and regulatory tools – have been confirmed via the evidence of the country reviews. There is now a much better understanding in most OECD countries of how these pillars need to be developed. Progress has been made in developing a stronger conceptual framework for regulatory quality, but there is some way to go yet for regulatory quality to be firmly implanted in practice into the wider governance framework of most OECD countries. In general, all three pillars of regulatory quality need strengthening. Regulatory policy needs to be more clearly articulated in many cases, and its importance promoted and assimilated across all levels of government. Regulatory policy is a dynamic and continuous process. The institutional context within which regulatory quality needs to be embedded is more complex than was

Box 5.5. **Taking the 1997 Principles and the 1995 checklist forward: The regulatory policy perspective**

- The checklist and principles should reflect the dynamic dimension of regulatory policy and processes. Regulatory quality is a continuous process. Existing regulation needs updating to ensure it remains effective and relevant.
- *Ex post* as well as *ex ante* evaluation are important tools.
- A supportive institutional architecture is critical, whilst taking care to respect individual countries' traditions and structures.
- Regulatory policy must be integrated into the long term policy agenda for structural reform. Regulatory quality is not just about individual rules, but also whole regulatory regimes and the interactions between regulatory regimes and policy goals.
- Substantive as well as legal quality is important and needs to be underlined, to emphasise the linkages between regulation or regulatory frameworks and policy goals.

perhaps first appreciated, raising a challenge for the evolution of new central structures to promote regulatory quality, as well as problems of fragmentation and inadequate linkages between different bodies. Regulatory tools, most importantly RIA, have considerable scope for improvement. The pace of progress is often slow and uneven. Because many countries are still at a basic level in practice, the gap between regulatory leaders and followers appears to be widening. Working to improve existing tools for the support of regulatory quality, notably RIA, remains important.

The 1995 checklist and the 1997 Principles remain highly relevant but can better reflect the lessons of a decade of implementation. The three most important new ingredients for regulatory quality missing from the 1995 checklist and which need greater emphasis in the 1997 Principles are the dynamic perspective, *ex post* evaluation of regulatory performance, and the institutional dimension (Box 5.5).

Notes

1. Regulations are the instruments by which a government places requirements on enterprises, citizens and the government itself. They include all primary laws and all other subsidiary rules, issued by all levels of government, as well as rules issued by non-governmental bodies to which governments have delegated regulatory powers. They cover economic, social, and sectoral regulation among others, as well as administrative regulation (paperwork and administrative formalities through which governments collect information and intervene in individual economic decisions).
2. For example the French Conseil d'État.
3. Some of the German Länder representatives in the Bundesrat for example have been promoting better evaluation.
4. The term is used here for simplicity, but can be misleading for some countries. No simple definition exists, but very broadly they are semi autonomous agencies working within the ambit of policies set by governments under which they have specific delegated responsibilities. It should also be noted that some countries have had independent regulators for many decades. Norway's independent regulators (the *tilsyn*) were established before the Second World War; the issue of their authority and scope is now being revisited in the wake of the market reforms of the 1980s and 1990s. Independent regulators have also been a feature of the US institutional landscape for many decades.

5. For example several Australian states pioneered the use of RIA. Australia also shows the potential for cooperatively negotiated reform agendas between federal and state governments, by devising an imaginative system of financial incentives for promoting competition principles in the economy.
6. See Economics Department paper referenced in note 6 in Chapter 1 for more detail on some of the budgetary aspects. The work underway as part of the OECD's Fiscal Federalism project is also relevant.
7. The economic and political context varies among countries and determines what is feasible and appropriate. For example, if screening criteria include structural tests such as the number or relative size of firms in an industry, suitable levels might vary with the volume of trade and the scale of the local economy.
8. WTO commitments on transparency (such as notification procedures set out in TBT and SPS Agreements) have also broken new ground in promoting wider transparency of regulations.
9. These may cover a wide range of issues: not only wages, but employment policy and issues of working life such as social services, pension schemes, and taxation.
10. The term here means all public authorities involved in the rule-making process, from independent regulators to governments.
11. See "Regulatory Performance: Ex post Evaluation of Regulatory Policies" *www.oecd.org/regreform*.
12. The German reunification burden and consequences, for example, are a major, perhaps the most important, factor affecting that country's recent economic performance. UK rail problems were largely due to chronic lack of investment over decades.
13. Reforms such as linking expenditure to outputs and outcomes, and evaluation of the effectiveness of public spending and of the efficiency of the administration which manages the spending (see *Modernising Government: The Way Forward*, OECD (2005).
14. For example, they might be given a say in the changes and a stake in the end result, such as cheap shares out of privatisation.

Chapter 6

The Broad Economic Context: Performance and its Drivers

Economic performance in OECD countries over the last two decades: A mixed picture

Regulatory reform, when conducted in synergy with other structural reforms, is reflected in better economic performance. The need for strong and sustained economic growth to maximise social welfare is an essential foundation for the achievement of public policy goals. This chapter reviews the linkages between regulation and economic performance, highlighting the potential for further gains from a dynamic approach to evaluate the stock of existing regulations and improve the quality of new ones.

The evolution of GDP per capita across OECD countries over the last decade or so has not been uniform.[1]

- Over the 1990s growth of trend GDP per capita in the US, as well as in Canada and Australia, has been somewhat faster than in the EU and, more strikingly so, than in Japan. The GDP per capita gap between the average OECD country and the US widened reversing the decades-long process of convergence in standards of living in the OECD area.
- Within the EU, GDP per capita trends have varied considerably, with the large continental economies (France, Germany, Italy) experiencing a significantly lower growth in GDP per capita than average during the 1990s, with widely varying rates of unemployment and labour force participants.
- The functioning of labour markets may be considered a critical determinant of performance.

The factors which determine the growth of GDP per capita highlight labour utilisation (hours worked per capita) and labour productivity (output per hour worked), which are shaped in turn by labour and product market policies[2] and their interaction.

Structural policies and reforms make an important contribution to performance

Structural policies and reforms are a powerful complement to fiscal and monetary stabilisation policies in creating the conditions for sustained growth. A country's structural policies have an important influence on its performance. Specifically, labour and product market policies can have a significant impact on structural unemployment, trend labour force participation, and the potential for labour productivity growth.[3]

More labour market reforms are needed in many countries to boost labour utilisation and labour productivity growth

Labour market policy reform efforts have been made, and continue to be made, in many countries. In most cases these reforms could be strengthened.

Differences between countries in the levels and rates of growth of labour utilisation partly reflect varying cultural preferences, but they are also influenced by government policies that affect the choice between leisure and work. Evidence is growing that policies such as tax and

benefit systems, the degree of employment protection and collective bargaining arrangements are likely to have depressed employment rates in many EU countries through their effects on labour force participation and/or the structural unemployment rate. For example the participation of older workers may be depressed by social security and pension arrangements that impose an implicit tax on continued work after the age of 55. Improving incentives for the labour force participation of older workers and of women appears crucial.

Product market reforms, including regulatory reforms, also help performance

OECD countries have developed an increasing awareness of the important linkages between product market policies and performance. Two important links can be made, the first with productivity, and the second with employment rates.

The link with a better productivity performance

To achieve reform, governments have to become more flexible and adaptive. The challenge lies in initiating and sustaining regulatory reform in the absence of a crisis, where pressures for doing so are weak and constituencies are diffuse.

Countries that have extensively reformed their product markets experienced an acceleration of productivity over the 1990s, while a productivity slowdown (or stagnation) has continued in other countries. Both the promotion of competition and privatisation are found to have a significant positive effect on productivity growth with productivity gaps relative to best practice being bridged faster in countries that have competition-oriented industry-level regulations. Product market competition affects the level and growth of productivity through four main channels (Box 6.1).

The link with higher employment rates

Product market competition can also play an important role in lowering structural unemployment rates, mainly because competitive pressures eliminate rents and make it possible to expand potential output. The gains in employment rates to be obtained from competition-friendly policies may be substantial. Conservative estimates suggest that many EU countries could raise trend employment rates by up to 2% simply by aligning their regulatory frameworks with the average among OECD countries. Even larger gains could be expected from further product market reforms that would bring EU countries closer to OECD best practice. Part of the explanation for differences in trend employment rates across the OECD can be found in the different pace and scope of product market reforms.[4]

There is a strong relationship between product market policies and regulatory reform

Product market policies aimed at increasing competition have a strong direct relationship with high quality regulation and regulatory reforms. Traditionally in many OECD countries, product market policies have been underpinned by rules and regulatory frameworks that have the effect of restraining market entry and competition. Regulatory reforms aimed at lowering barriers to market entry – reducing barriers to trade, developing more effective competition policies, easing entry conditions into domestic markets, and increasing the use of market based or incentive mechanisms in difficult sectors such as the network industries – have been central to recent developments in product market policy in many countries:

- *Reducing traditional barriers to trade.* With a few exceptions (such as agriculture) tariff barriers have fallen in the OECD area over recent years. Tariffs rates have declined

Box 6.1. **Product market competition and the link of productivity**

Product market competition affects the level and growth of productivity through **four** main channels:

- *Innovation*. The attempt to acquire a competitive edge on rival firms often results in a stronger innovation effort, for instance through increased expenditure on R&D and patenting. Pro-competitive regulations are often found to have a positive impact on innovation activity in empirical research.
- *Diffusion*. Competitive pressures provide strong incentives for firms to reach the technological frontier, mainly due to the threat of losing market shares *vis-à-vis* competitors. Investment in ICT has been higher in countries with a more competitive domestic environment. Also, countries that underwent extensive product market reforms also found it easier to translate such investment into productivity improvements in crucial ICT-using sectors, so increasing its contribution to aggregate productivity growth.
- *Efficiency*. Competitive markets force management to reduce slack in the use of labour and capital resources (the so-called x-inefficiency).
- *Capital spending*. Policies promoting competition are also shown to stimulate investment in sectors that are large users of new technologies, and encourage foreign inward direct investment (FDI), a major channel for technology transfer. Recent OECD analysis suggests that open and competitive business environments have made some OECD countries more attractive to FDI.

substantially in most OECD countries. The same can broadly be said for restrictions on FDI, though the picture is more uneven.

- *Promoting domestic competition*. This has taken three main forms, better design and enforcement of general competition laws, liberalisation of entry into non-manufacturing industries, and administrative reforms. Competition laws have been reformed: nearly all OECD countries have either established or substantially improved their competition laws over the past two decades. Though comprehensive recent data for non-manufacturing industries is not available,[5] often extensive reforms have been carried out in the network sectors, especially in electricity and telecommunications.
- *Simplifying administrative procedures*. In the mid-1990s, procedures, costs and delays for complying with frequently opaque administrative requirements were especially burdensome in the large continental European countries and Japan. These barriers may have fallen in some countries, though this is not universal and in some cases complexity has increased.

Product market and related regulatory reforms remain a "work-in-progress" agenda

All these developments are still work-in-progress. Weak areas in many countries are a range of service markets and the network sectors, which often still suffer from dominant incumbents. In many cases too, regulation continues to stifle entry and business conduct in services markets, and an uneven enforcement of competition laws still curbs competitive pressures in many continental European countries, Japan and some new OECD

members and transition countries. Weak competition pressures in the non-manufacturing industries is an important issues because these industries (notably communications, transport, retail distribution and business services) are potentially heavy users of ICT, which links to the weaknesses in the renewal of capital stocks and productivity growth.[6]

Notes

1. This chapter draws on ECO/CPE(2003)19 "Taking Stock of Structural Policies in OECD Countries: A Preliminary Assessment" and its Annex, presented in October 2003 to the OECD's Economic Policy Committee.
2. Other policies are highly relevant too, such as public sector policies. The analysis here focuses specifically on labour and product market policies.
3. Recent research strongly suggests that policies promoting competition and the adaptability of labour markets play a primary role. Policies affecting human capital formation, and the efficiency of financial markets and corporate governance mechanisms are also relevant, among others. The relatively limited focus here is on certain product and labour market policies.
4. For example such reforms are likely to have been an important complement to adaptable labour markets in raising employment rates in North America, Australia, New Zealand and some EU countries such as the UK and Ireland.
5. OECD databases are currently in the process of being updated.
6. ICT is not the only issue.

Chapter 7

Conclusion: The OECD Principles of 1997 and 2005

Renewal of the 1997 Principles on regulatory reform

The goal of regulatory reform is to improve national economies and enhance their ability to adapt to change. Better regulation and structural reforms are necessary complements to sound fiscal and macroeconomic policies. Continual and far-reaching social, economic and technological changes require governments to consider the cumulative and inter-related impacts of regulatory regimes, to ensure that their regulatory structures and processes are relevant and robust, transparent, accountable and forward-looking. Regulatory reform is not a one-off effort but a dynamic, long-term, multi-disciplinary process.

An interdisciplinary approach to regulatory policy is fundamental. Product market regulatory reforms are an important component of structural policies that support sustained economic growth. Competition policies are stronger and more coherent, and regulatory policies are strengthened when the two policies converge. Regulatory policy and market openness also support each other, as foreign as well as domestic businesses are encouraged by an effective regulatory environment. Even more broadly, regulatory policy is part of a wider framework for policy integration in complex modern societies, and can help governments to meet policy objectives more efficiently and effectively. The more recent country reviews have started to explore promising linkages between regulatory policy and an even broader range of policy areas than have been covered so far.

The first set of OECD policy recommendations for regulatory reform was endorsed by Ministers in 1997. They have provided guidance to member countries to improve regulatory policies and tools, strengthen market openness and competition, and reduce regulatory burdens. The country reviews of regulatory reform launched in 1998 and the monitoring exercises of implementation launched in 2004 document the considerable progress that has been made and identify lessons about implementation to promote a strong competition culture and liberalisation of entry barriers, the use of regulatory impact analysis and consideration of alternatives to regulation, and the integration of market openness criteria in regulatory processes.

In the meantime, and notwithstanding significant progress, current challenges continue to demand attention. More work is needed to open markets to greater competition, especially in the network sectors, and some product and service markets such as the retail trade and professional services. Administrative burdens remain high and appear to be growing, sometimes alongside a growing complexity in the rules.

A key emerging challenge for the application of high quality regulation which has been comparatively neglected is "regulation inside government". The application of regulatory quality principles to this large area of activity would do much to support better economic and social welfare performance. The international dimension of regulation is also a growing issue, not yet well mastered, as regulators increasingly find themselves working within broader institutional contexts.

There is a much better understanding of regulatory policy and its components today compared with the mid 1990s. Yet the 1995 checklist about regulatory decision-making and the 1997 Principles about policy on regulatory reform remain highly relevant. This is confirmed by each element of the reviews. Key elements making up an effective regulatory landscape have become clearer since 1997. Among the central issues to have emerged through the work of the last few years are the need to ensure that all central as well as local government institutions are part of the regulatory quality process; the dynamic nature of effective regulatory policy as permanent element of the broader public governance agenda; and the importance of effective communication on regulatory issues as well as cultural change within administrations. The competition policy reviews note that competition policy has been and remains an important driver for reform in many countries as they seek to develop or consolidate a strong market economy. These reviews conclude that the Principles remain sound even if putting them into practice is still work-in-progress. The market openness reviews demonstrate, for their part, that the global trade community is a powerful driver for moving the domestic regulatory agenda forward. They also confirm that the Principles (and the six efficient regulation principles relevant to market openness) remain valid, but underline that implementation remains an issue and that a fundamental evolution in regulatory culture is needed to assimilate the trade perspective.

The 2005 Principles for regulatory quality and performance

The concept of regulatory reform has changed over the last decade, a change that is reflected in the title for these principles. The focus in the 1990s was on steps to reduce the scale of government, often carried out in single initiatives. Isolated efforts cannot take the place of a coherent, whole-of-government approach to create a regulatory environment favourable to the creation and growth of firms, productivity gains, competition, investment and international trade. Removing unneeded regulations, notably in sectors that meet public needs, is still important, but does not tell the whole story. When governments turn elsewhere for provision of services, regulation is necessary to shape market conditions and meet the public interest. "Regulatory quality and performance" captures the dynamic, ongoing whole-of-government approach to implementation.

The 1997 Recommendations have stood the test of time. Based on the lessons of experience drawn from 20 country reviews and other studies, these recommendations have been carefully examined and updated to help countries face the challenges of the 21st century with a renewed commitment toward better regulation. The original 7 principles have been retained, but the explanatory notes and subordinate recommendations have been expanded. Issues which receive greater attention in 2005 than in 1997 include: policy coherence and multi-level co-ordination; ex *ante* assessment of proposals for policy; competition policy for network utilities that meet public needs; market openness; risk awareness; and implementation. This agenda calls for a cross-sectoral, pro-active approach to make regulations more responsive yet predictable. The 2005 Principles on Regulatory Quality and Performance highlight the dynamic, forward-looking process by which regulatory policies, tools and institutions are adapted for the 21st century.

More non-member countries are taking an interest in regulatory reform issues, as demonstrated by the recent review of Russia, the first of a non-member country, the participation of Brazil and Chile as observers in the SGRP, conferences on regulatory policies in China 2003 and 2004, the Regulatory Governance Initiative as part of the Investment Compact for South East Europe, and the completion of the APEC-OECD

Integrated Checklist for Regulatory Reform. Regulatory Reform is a key theme in the Programme on Good Governance for Development in Arab Countries, supported by the OECD and the UNDP. The implementation of policies for better regulation however is difficult in many transition and developing countries, when institutional and democratic systems are still fragile. Bilateral and multilateral development assistance programmes are helping to build capacity for regulatory impact analysis and regulatory policy systems in many countries, where over time, regulatory processes and standards can be expected to improve transparency, accountability and economic outcomes. The 2005 Principles will therefore have an impact beyond OECD member countries, wherever governments strengthen domestic policies and institutions in ways that improve investment and trade.

This set of principles were discussed by delegates to the Competition and Trade Committees and to the Working Party and Regulatory Management and Reform on the basis of stocktaking exercises to identify lessons about implementation drawn out of the 20 country reviews completed through 2003, and summarised in this synthesis report, "Taking Stock of Regulatory Reform". The Special Group on Regulatory Policy approved the Principles at its 4th meeting on 15 March 2005, and the Council of the OECD endorsed them on 28 April 2005.

To ensure further progress, high level political commitment is needed. Ultimately, the regulatory policy agenda should help OECD countries renew and strengthen their action plans to achieve a higher standard of regulatory quality, and should indicate the way forward for many countries in development which seek to adopt and implement strategies for regulatory reform.

Chapter 8

The Guiding Principles for Regulatory Quality and Performance

1. Adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation

Commit to regulatory reform at the highest political level, recognizing that key elements of regulatory policy – policies, institutions and tools – should be considered as a whole, and applied at all levels of government. Articulate reform goals, strategies and benefits clearly to the public.

Establish principles of "good regulation", drawing on the 1995 OECD Recommendation on Improving the Quality of Government Regulation *(see annex)*. Good regulation should: *i)* serve clearly identified policy goals, and be effective in achieving those goals; *ii)* have a sound legal and empirical basis; *iii)* produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account; *iv)* minimise costs and market distortions; *v)* promote innovation through market incentives and goal-based approaches; *vi)* be clear, simple, and practical for users; *vii)* be consistent with other regulations and policies; and *viii)* be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.

Create effective and credible co-ordination mechanisms, foster coherence across major policy objectives, clarify responsibilities for assuring regulatory quality, and ensure capacity to respond to a changing, fast-paced environment. Ensure that institutional frameworks and resources are adequate, and that systems are in place to manage regulatory resources effectively and to discharge enforcement responsibilities. Strengthen quality regulation by staffing regulatory units adequately, conducting regular training sessions, and making effective use of consultation, including advisory bodies of stakeholders.

Encourage better regulation at all levels of government, improve co-ordination and avoid overlapping responsibilities among regulatory authorities and levels of government; apply regulatory quality criteria such as transparency, non-discrimination and efficiency to regulation inside government, and encourage private bodies such as standards-setting organisations to adopt criteria for regulatory quality based on the OECD Recommendations.

Adopt a dynamic approach to improve regulatory systems over time to improve the stock of existing and the quality of new regulations, and ensure that reforms are carried out in a logical order and that related markets are liberalised together, where practicable. Make effective use of ex post valuation.

2. Assess impacts and review regulations systematically to ensure that they meet their intended objectives efficiently and effectively in a changing and complex economic and social environment

Review regulations (economic, social, and administrative) against the principles of good regulation and from the point of view of those affected rather than of the regulator; update regulations through automatic review procedures such as sun-setting.

Consider alternatives to regulation where appropriate and possible, including self-regulation, that give greater scope to citizens and firms; when analysing such alternatives, consideration must take account of their costs, benefits, distributional effects, impact on competition and market openness, and administrative requirements.

Use performance-based assessments of regulatory tools and institutions, to assess how effective they are in contributing to good regulation and economic performance, and to assess their cost-effectiveness.

Target reviews of regulations where change will yield the highest and most visible benefits, particularly regulations restricting competition and market openness, and affecting enterprises, including SMEs.

Review proposals for new regulations, as well as existing regulations, with reference to regulatory quality, competition and market openness; ensure compliance with quality standards when drafting or reviewing regulations preferably overseen by a body created for that purpose.

Integrate regulatory impact analysis into the development, review, and revision of significant regulations, and use RIA to assess impacts on market openness and competition objectives; support RIA with training programmes, and with *ex post* evaluation to monitor quality and compliance; include risk assessment and risk management options in RIAs. Ensure that RIA plays a key role in improving the quality of regulation, and is conducted in a timely, clear and transparent manner.

Minimize the aggregate regulatory burden on those affected as an explicit objective to lessen administrative costs for citizens and businesses and as part of a policy stimulating economic efficiency. Measure the aggregate burdens while also taking account of the benefits of regulation.

3. Ensure that regulations, regulatory institutions charged with implementation, and regulatory processes are transparent and non-discriminatory

Establish regulatory arrangements that ensure that the public interest is not subordinated to those of regulated entities and stakeholders.

Consult with all significantly affected and potentially interested parties, whether domestic or foreign, where appropriate at the earliest possible stage while developing or reviewing regulations, ensuring that the consultation itself is timely and transparent, and that its scope is clearly understood.

Ensure that firms in an industry are not subject to firm-specific benefits or costs arising from regulation, unless such benefits or costs are demonstrably necessary to benefit the public or to prevent the exercise of market power.

Create and update on a continuing basis public registries of regulations and business formalities, or use other means of ensuring that domestic and foreign businesses can

easily identify all requirements applicable to them. Electronically accessible, interactive websites should be a priority to make rulemaking information available to the public, and to receive public comment on regulatory matters.

Ensure that administrative procedures for applying regulations and regulatory decisions are transparent, non-discriminatory, contain an appeal process against individual actions, and do not unduly delay business decisions; ensure that efficient appeals procedures are in place.

Ensure that regulatory institutions are accountable and transparent, and include measures to promote integrity.

4. Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy

Eliminate sectoral gaps in coverage of competition law, unless evidence suggests that compelling public interests cannot be served in better ways. Competition law enforcement and sector regulation to promote competition and trade liberalisation should be co-ordinated to ensure consistency.

Enforce competition law vigorously where collusive behaviour, abuse of dominant position, monopolisation or anticompetitive mergers risk frustrating reform. Employ effective tools such as leniency programmes to detect and deter hard-core cartel violations. Sanctions imposed against anti-competitive conduct should be sufficient to deter violations; that is, they should be proportionate to the violators' expected gain, the risk of detection and the risk of public harm.

Provide competition authorities with the authority and capacity to advocate reform, and support public awareness of the role and benefits of competition.

5. Design economic regulations in all sectors to stimulate competition and efficiency, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests

Ensure that regulatory restrictions on competition are limited and proportionate to the public interests they serve.

Periodically review those aspects of economic regulations that restrict entry, access, exit, pricing, output, normal commercial practices, and forms of business organisation to ensure that the benefits of the regulation outweigh the costs, and that alternative arrangements cannot equally meet the objectives of the regulation with less effect on competition.

Promote efficiency and the transition to effective competition where economic regulations continue to be needed because of potential for abuse of market power. In particular: *i)* in appropriate cases such as privatisation and the reform of markets that are in the process of opening up to competition, separate potentially competitive activities from regulated utility networks, and otherwise restructure as needed to promote competition; *ii)* promote non-discriminatory access to essential network facilities to all market participants on a timely and transparent basis; *iii)* promote inter-connection of networks between geographically neighbouring areas; and *iv)* use price regulation mechanisms including price caps and other mechanisms such as price monitoring and disclosure regimes to encourage efficiency gains when price controls are needed.

Promote choice by consumers of the firm with which they deal so that they can switch firms at efficient cost and without undue restrictions.

Periodically review the state ownership stake or financial interest in undertakings with market power and whether they unduly impair competition or impede pro-competitive reforms.

Periodically review the need for universal service obligations, their effectiveness and the need to maintain restrictions on entry and prices.

6. Eliminate unnecessary regulatory barriers to trade and investment through continued liberalisation and enhance the consideration and better integration of market openness throughout the regulatory process, thus strengthening economic efficiency and competitiveness

Better integrate the consideration of market openness principles within the design and implementation of regulations and the conduct of RIAs, taking account of the increasing role of domestic regulatory environments in determining market openness in light of advances in trade and investment liberalisation.

Implement, and work with other countries to strengthen, international rules and principles to further liberalise trade and investment paying particular attention to transparency, non-discrimination, avoidance of unnecessary trade restrictiveness, harmonisation towards international standards, streamlining of conformity assessment procedures and application of competition principles.

Reduce as a priority matter those regulatory barriers to trade and investment arising from divergent and duplicative or outdated requirements by countries.

Support the development and use of internationally harmonised standards as a basis for domestic regulations and their review and improvement in collaboration with other countries, to assure they continue to achieve their intended policy objectives efficiently and effectively.

Elaborate clearly defined criteria for accepting foreign standards, measures and qualifications as equivalent to domestic ones when they pursue the same regulatory objective. Provide transparent and accessible avenues for foreign producers and service suppliers wishing to demonstrate equivalence.

Expand recognition of other countries' conformity assessment procedures and results through, for example, mutual recognition agreements (MRAs), unilateral recognition of equivalence, promotion of supplier's declaration of conformity or other means. Encourage the development of domestic capacity for accreditation and ensure its ease of access.

7. Identify important linkages with other policy objectives and develop policies to achieve those objectives in ways that support reform

Apply principles of good regulation when reviewing and adapting policies in areas such as reliability, safety, health, consumer protection, and energy security so that they remain effective, and as efficient as possible within competitive market environments; pursue liberalisation when the benefits of competition and market openness are consistent with the achievement of other key policy objectives; broaden the scope for regulatory quality to include public services. Recognize that as policy objectives multiply, the task of designing and evaluating regulations becomes more challenging.

Assess risk to the public and to public policy in a changing environment as fully and transparently as possible, thereby contributing to a better understanding of the responsibilities of all stakeholders.

Review non-regulatory policies, including subsidies (both direct and indirect) and procurement policy, and adjust them where they unnecessarily distort competition and market openness.

Ensure that programmes designed to ease the potential costs of regulatory reform are focused and transitional, and facilitate, rather than delay, the process of adjustment.

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OECD Reviews of Regulatory Reform

Taking Stock of Regulatory Reform
A MULTIDISCIPLINARY SYNTHESIS

Since 1997, OECD has carried out 20 country reviews of regulatory reform in a multi-disciplinary perspective embracing competition, market openness and capacity for regulatory quality as well as sectors, principally in network utilities. What problems and challenges have countries faced when introducing or improving policies and action plans for regulatory reform? What lessons can be learned about implementation? What are the shortcomings of reform, and how can current policies be implemented more effectively? To answer such questions, OECD carried out a broad, cross-disciplinary exercise to take stock and consider the future. This synthesis report validates the dynamic, ongoing nature of regulatory reform, highlights the mutually supporting and synergistic relationship among policies for competition, market openness and regulatory quality, and elaborates an agenda of work to bring the benefits of regulatory reform into the 21st century.